

UNITED STATES DISTRICT COURT.
FOR THE DISTRICT OF COLUMBIA

ELOUISE PEPION COBELL, : Civil Action 96-1285
et al. :
Plaintiffs :
V. : Washington, D.C.
: Wednesday, October 24, 2007
:
DIRK KEMPTHORNE, Secretary :
of the Interior, et al. :
:
Defendants : MORNING SESSION
TRANSCRIPT OF EVIDENTIARY HEARING
DAY 9
BEFORE THE HONORABLE JAMES ROBERTSON
UNITED STATES DISTRICT JUDGE

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Page 1764					Page 1766				
For the Defendants: ROBERT E. KIRSCHMAN, JR., ESQUIRE					1 PROCEEDINGS				
JOHN WARSHAWSKY, ESQUIRE					2 THE COURT: Good morning, Mr. Gingold.				
MICHAEL QUINN, ESQUIRE					3 MR. GINGOLD: Good morning, Your Honor. Plaintiffs				
J. CHRISTOPHER KOHN, ESQUIRE					4 would like to call for their first witness today, Mr. Kevin				
U.S. Department of Justice					5 Gambrell.				
1100 L Street, N.W.					6 THE COURT: I didn't hear that.				
Washington, D.C. 20005					7 MR. GINGOLD: Mr. Kevin Gambrell.				
(202) 307-0010					8 THE COURT: All right.				
JOHN STEMPLEWICZ, ESQUIRE					9 (Oath administered by Courtroom Deputy.)				
Senior Trial Attorney					10 MR. GINGOLD: Your Honor, briefly, Mr. Gambrell is the				
U.S. Department of Justice					11 former head of the Federal Indian Minerals Office in Farmington,				
Commercial Litigation Branch					12 New Mexico. And he will testify today with regard to the				
Civil Division					13 absence of internal controls, the incompleteness of Trust				
Ben Franklin Station					14 records, and the lack of data integrity.				
P.O. Box 975					15 He will further testify with respect to accounting				
Washington, D.C. 20044					16 irregularities, mis-collections, and deficiencies in MMS in				
(202) 307-1104					17 collecting and properly reporting income.				
Court Reporter: REBECCA STONESTREET					18 THE COURT: All right, sir, you may proceed.				
Official Court Reporter					19 MR. GINGOLD: Thank you, Your Honor.				
Room 6511, U.S. Courthouse					20 (KEVIN GAMBRELL, PLAINTIFF witness, having been duly sworn,				
333 Constitution Avenue, N.W.					21 testified as follows:)				
Washington, D.C. 20001					22 DIRECT EXAMINATION				
(202) 354-3249					23 BY MR. GINGOLD:				
Proceedings reported by machine shorthand, transcript produced					24 Q. Mr. Gambrell, where do you currently reside?				
by computer-aided transcription.					25 A. I currently reside in Farmington, New Mexico.				
Page 1765					Page 1767				
CONTENTS					1 Q. And what is your current employment?				
WITNESS DIRECT CROSS REDIRECT RECROSS					2 A. I'm an energy consultant. I provide information, do data				
KEVIN GAMBRELL					3 analysis, economics accounting for private landowners, industry,				
By Mr. Gingold 1766 -- -- --					4 and other groups.				
DON PALLAIS					5 Q. And how long have you been doing that?				
By Mr. Dorris 1816 -- -- --					6 A. I've been doing this for four years.				
EXHIBITS					7 Q. Prior to becoming an energy consultant, what were you doing?				
NUMBER ADMITTED					8 A. I was the director of the Federal Indian Minerals Office.				
(No Exhibits Moved into Evidence.)					9 Q. And what is the Federal Indian Minerals Office?				
					10 A. It's an office in the Four Corners that was created under a				
					11 lawsuit called the Shii Shi Keyah Allottee Association versus				
					12 Department of Interior, in which landowners were not getting				
					13 paid royalties. And the office was created to bring the other				
					14 three bureaus under one office director, myself, which included				
					15 the Bureau of Indian Affairs, Mineral Management Services,				
					16 Bureau of Land Management, and some of the OST functions.				
					17 My authorities given to me were equal to that of a				
					18 regional director, the Bureau of Indian Affairs; a BLM field				
					19 manager; and an MMS chief audit compliance officer.				
					20 Q. So this office was an office of the Department of the				
					21 Interior. Is that correct?				
					22 A. Yes, it was the first of its kind. It was a pilot project,				
					23 and it became departmentalized within the Department of Interior				
					24 in 2001, and was to be expanded to other locations throughout				
					25 the -- throughout Indian country: Billings, Montana; Fort				

Page 1768	Page 1770
<p>1 Duchesne, Utah; and Anadarko, Oklahoma.</p> <p>2 Q. Is the scope of work within the office including -- does it</p> <p>3 include tribes as well as individual Indian mineral information?</p> <p>4 A. No, this office was specifically for individual Indian</p> <p>5 mineral owners.</p> <p>6 Q. Prior to becoming a head of the FIMO office --</p> <p>7 MR. GINGOLD: Your Honor, the acronym is F-I-M-O.</p> <p>8 BY MR. GINGOLD:</p> <p>9 Q. Prior to becoming head of the FIMO office, what was your</p> <p>10 employment?</p> <p>11 A. My employment was a mining financial analyst for the Navaho</p> <p>12 Nation. And I had similar duties as I did in the FIMO office.</p> <p>13 However, I did my work specifically for the tribe. I managed a</p> <p>14 \$100 million lockbox, watched royalties coming in and out, made</p> <p>15 sure the tribe was paid correctly, managed an inspection</p> <p>16 enforcement team, did lease analysis and contract analysis for</p> <p>17 the tribe, provided advisement in doing settlements and writing</p> <p>18 new contracts, provided forecasting analysis for the council,</p> <p>19 and any other information required by the executive branch or</p> <p>20 legislative -- or the council within the Navajo Nation, or even</p> <p>21 the judicial branch.</p> <p>22 Q. How long was your employment with the Navajo Tribe?</p> <p>23 A. My employment with the tribe was for three years.</p> <p>24 Q. During the course of -- by the way, prior to your employment</p> <p>25 with the tribe, did you have any experience with regard to</p>	<p>1 A. One thing that we realize --</p> <p>2 THE COURT: I would prefer a Q&A rather than a</p> <p>3 narrative discussion, Mr. Gingold.</p> <p>4 MR. GINGOLD: I wasn't going to interrupt him, Your</p> <p>5 Honor.</p> <p>6 BY MR. GINGOLD:</p> <p>7 Q. What particular issues did you have when you were dealing</p> <p>8 with, for example, the MMS systems while you were at Navajo?</p> <p>9 A. One of the biggest issues we had was depending on the</p> <p>10 databases that were provided by MMS, royalty and production</p> <p>11 databases. So we actually created our own databases. And we</p> <p>12 had two technical staff that would do data entry, and I created</p> <p>13 a system to do verification in which there was double entry</p> <p>14 verification to keep the data with integrity.</p> <p>15 One problem is that when we saw MMS reports, we would</p> <p>16 often see negative entries and positive entries that made no</p> <p>17 sense. We had -- we actually had one case where we actually had</p> <p>18 a million dollar deposit that should have gone to another lease</p> <p>19 and ended up on another company lease, and we had to readjust</p> <p>20 that out after some years.</p> <p>21 And so we never could really trust those data systems.</p> <p>22 In fact, that's why we went to the lockbox, a general fund</p> <p>23 type -- an account where we had royalties deposited directly to</p> <p>24 the tribe versus going through the MMS system, because we did</p> <p>25 not trust the monies going into their systems and then coming</p>
Page 1769	Page 1771
<p>1 either Tribal or individual Indian mineral leases?</p> <p>2 A. Not before the tribe.</p> <p>3 Q. And your academic background, what is it?</p> <p>4 A. My academic background ground, I have a bachelor's in</p> <p>5 international trade relations, and I have a master of science in</p> <p>6 mineral economics from the Colorado School of Mines.</p> <p>7 THE COURT: Did you say the Colorado School of Mines?</p> <p>8 THE WITNESS: Yes, I did, Your Honor.</p> <p>9 BY MR. GINGOLD:</p> <p>10 Q. Where is the Colorado School of Mines located?</p> <p>11 A. Colorado School of Mines is located in Golden, Colorado.</p> <p>12 Q. During the course of employment with the tribe, did you</p> <p>13 experience -- did you have experience working with any of the</p> <p>14 Interior management systems?</p> <p>15 A. Yes, I did.</p> <p>16 Q. Did you have any experience with regard to the MMS system?</p> <p>17 A. Yes. We had several systems within the Navajo Nation</p> <p>18 minerals department. We had an audit contract agreement with</p> <p>19 the minerals management department, in which we had our own</p> <p>20 auditors doing the work. We also had a BLM function, and also a</p> <p>21 BIA function, within the minerals department.</p> <p>22 With regard to the Mineral Management Service function</p> <p>23 of auditing, we often did not -- we had a lot of issues within</p> <p>24 that system that I would like to discuss.</p> <p>25 Q. Go right ahead.</p>	<p>1 back to the tribe. It didn't come in timely, and it often came</p> <p>2 with many errors.</p> <p>3 Q. What type of errors did you identify?</p> <p>4 A. There were always issues with regard to production and</p> <p>5 royalty data. We had entries that came in, double entries,</p> <p>6 often; we had production databases that -- inventories didn't</p> <p>7 make any sense. If you didn't actually know what was happening</p> <p>8 in the field, you couldn't really verify that the production was</p> <p>9 correct.</p> <p>10 And so we actually had to -- we actually just developed</p> <p>11 our own system. We also had a problem with some of the lease</p> <p>12 universe data held within MMS system. Often their rental dates</p> <p>13 were incorrect, the royalty rates in some cases were incorrect.</p> <p>14 Within the BLM system, we found that the unit agreement</p> <p>15 allocation (sic) data was incorrect.</p> <p>16 And so we created our own --</p> <p>17 THE COURT: Unit agreement allocation?</p> <p>18 THE WITNESS: Unit allocation agreement. It is where</p> <p>19 you have multiple leases from different types of lands - state,</p> <p>20 federal, tribe, Indian allotted - within one agreement. And the</p> <p>21 reason they do that is because when you have a glass of water,</p> <p>22 for example, and you have four straws in that water; you have</p> <p>23 four operators operating that lease, or that area. And what</p> <p>24 happens is, they try to out-drill the other operator and get</p> <p>25 that mineral out of the ground.</p>

Page 1772	Page 1774
<p>1 When they try to out-produce each other, what it does</p> <p>2 is it destroys the actual resource, and you get -- instead of</p> <p>3 recovering 80 percent, you recover 40 percent.</p> <p>4 So what we do is to create unit agreements for multiple</p> <p>5 types of land, and then we use that to develop the minerals with</p> <p>6 more conservation, and as efficiently as possible, with one</p> <p>7 operator.</p> <p>8 And in that case you'll find that Indian allotments and</p> <p>9 Tribal are mixed in with state and federal leases.</p> <p>10 MR. KIRSCHMAN: Your Honor, I'm going to object to the</p> <p>11 continuing line of this questioning. It relates clearly to</p> <p>12 asset management --</p> <p>13 THE COURT: I just asked him what unit allocation was.</p> <p>14 He was explaining the answer to me. Objection overruled. I</p> <p>15 don't think he was criticizing, I think he was explaining what</p> <p>16 they are.</p> <p>17 Go ahead, Mr. Gingold.</p> <p>18 BY MR. GINGOLD:</p> <p>19 Q. When you discussed, in response to the judge's question, how</p> <p>20 the unitization works, was allocation an important issue?</p> <p>21 A. Allocation is extremely critical in unit allocation. It is</p> <p>22 the essence of getting payment correctly to individual Indian</p> <p>23 owners, tribes, states, federal programs, and private</p> <p>24 landowners. Without it, you cannot allocate monies properly.</p> <p>25 Q. Could you explain how the allocation process works?</p>	<p>1 Q. That sounds like a cumbersome process. Is it?</p> <p>2 A. It's very complex. If you were to look at this type of</p> <p>3 system in a private landowner's case, oil and gas industry hires</p> <p>4 land people, they pay them very well, in the \$200,000 range, to</p> <p>5 go back and do this title research to find out who gets paid,</p> <p>6 how much they get paid, how do you allocate, et cetera.</p> <p>7 It also requires, in the private sector, a legal</p> <p>8 opinion from an attorney that's certified, that says that the</p> <p>9 title in the allocations are certified correct, and the division</p> <p>10 of interest will pay out correctly.</p> <p>11 It requires an extensive amount of work. It requires</p> <p>12 very high level land people and attorneys to do this type of</p> <p>13 work.</p> <p>14 Q. Is that what you did at the FIMO office when you were</p> <p>15 running the FIMO office?</p> <p>16 A. Repeat that.</p> <p>17 Q. Is that what you did at the FIMO office when you were</p> <p>18 running the FIMO office?</p> <p>19 A. Yes, that was part of what I did, and my staff did.</p> <p>20 Q. Do you have any knowledge as to whether or not this was done</p> <p>21 by MMS or anyone else outside of the FIMO office with regard to</p> <p>22 individual Indian mineral or oil and gas lands?</p> <p>23 A. No, I'm not. We were in a unique position. We had every</p> <p>24 agency within our office, so we looked at everything from the</p> <p>25 lease agreement itself, the BLM-approved communization</p>
Page 1773	Page 1775
<p>1 A. Allocation process goes all the way back to the lease</p> <p>2 instrument. In order to get money correctly to an individual,</p> <p>3 you have to understand every aspect of the lease instrument in</p> <p>4 terms of: Is it unitized, does it commingle, what is the size</p> <p>5 of the property, what type of production comes off that</p> <p>6 property; to, when it goes through the system, is it a correct</p> <p>7 royalty rate, is it going to the correct owners, is there</p> <p>8 probate backing up those owners?</p> <p>9 And when you do that, you have to look at source</p> <p>10 documents, and you have to do third party verification.</p> <p>11 Q. What do you mean, first of all, by source documents?</p> <p>12 A. Well, for example, if you look at an allocation to an</p> <p>13 individual Indian, in order to get to that allocation, I have to</p> <p>14 go all the way back to the unit agreement. And I have to look</p> <p>15 at an exhibit called Exhibit B within the unit agreement, that</p> <p>16 talks about the complete breakdown of every ownership type</p> <p>17 within that unit, because I may have 30 percent owned by</p> <p>18 federal, 20 percent by Navajo Tribal, 30 percent by Navajo</p> <p>19 allotted, and maybe 20 percent by private landowner.</p> <p>20 I have to go all the way back to that document as a</p> <p>21 primary source to get to the payment to the individual Indian.</p> <p>22 And then I have to go to the royalty rate, and then I have to go</p> <p>23 to the probates and look at probates, gift deeds, living wills,</p> <p>24 et cetera, in order to get to the complete payment out to the</p> <p>25 allottee.</p>	<p>1 agreements, to the probate. We looked at everything.</p> <p>2 THE COURT: This was when you were in FIMO?</p> <p>3 THE WITNESS: Yes, it was, Your Honor.</p> <p>4 THE COURT: Not when you were working for the Navajo?</p> <p>5 THE WITNESS: Within the Navajo, we also did title</p> <p>6 search and title verification, Your Honor.</p> <p>7 BY MR. GINGOLD:</p> <p>8 Q. Was there any event or particular circumstance - let's say</p> <p>9 when you were at Navajo - which caused the Navajo to take that</p> <p>10 approach?</p> <p>11 A. Yes, there were cases where we found that the BLM data for</p> <p>12 allocations on a particular unit was incorrect. And we went to</p> <p>13 the -- we made our own databases to verify those allocations.</p> <p>14 And then we would check our allocations against distribution by</p> <p>15 the companies, to make sure that they paid correctly.</p> <p>16 Q. Now, did the Navajo Nation rely on the MMS database?</p> <p>17 A. We tried not to. We tried to rely on it as little as</p> <p>18 possible, and tried to use our lockbox, collecting monies and</p> <p>19 company reports to us.</p> <p>20 Q. And why did you try not to rely on the MMS database?</p> <p>21 A. We felt the data was not sufficient to collect royalties and</p> <p>22 to determine production.</p> <p>23 Q. Was it incomplete?</p> <p>24 A. It was often incomplete, and more often inaccurate.</p> <p>25 Q. Did you bring that to the attention of MMS?</p>

4 (Pages 1772 to 1775)

Page 1776	Page 1778
<p>1 A. We brought it to the attention of MMS many times, and asked 2 that MMS make corrections on the reports, in which case often 3 they did. 4 Q. If you didn't rely on the MMS database, what did you rely 5 on? 6 A. We relied on our own internal databases that we developed 7 with companies, and we relied on companies' reports directly 8 going to us. 9 Q. So is it correct, then, that you relied on third party 10 information? 11 A. We relied on third party and primary source data. 12 Q. Are third party documents important to determining accuracy 13 with regard to mineral and oil and gas leases? 14 A. Absolutely. 15 THE COURT: Would you call that a leading question? 16 MR. GINGOLD: I apologize, Your Honor. 17 BY MR. GINGOLD: 18 Q. Why would you need to rely on third party data? 19 A. We rely on third party databases because we don't always 20 trust what an operator tells us. We have companies that produce 21 oil. They tell us one thing on their inventory and what they 22 sold; and then we go to a transporter, and we find that the 23 information is different, that they picked up more oil than the 24 company reported. 25 And so we do rely on run tickets from trucking</p>	<p>1 it fills up the truck, and then they measure the tank when the 2 truck is filled. And between the full measurement before the 3 truck filled up and the truck measurement after the truck fills 4 up is the quantity of oil that leaves the lease. 5 Q. And how is that related to the income produced from oil and 6 gas or mineral leases? 7 A. Anything to do with income depends on the volumes that are 8 sold off the lease. You cannot determine the monies going to 9 individual Indians if you do not know what was sold. 10 Q. Let's talk about your experience at FIMO, Federal Indian 11 Minerals Office, in Farmington, New Mexico. 12 Specifically, when were you hired there? 13 A. I was hired November 18th, 1996. 14 Q. And do you know why the Federal Indian Minerals Office was 15 created? 16 A. The Federal Indian Minerals Office was created because 17 individual Indian mineral owners in the Four Corners were not 18 getting paid. There were often times when they would see a 19 payment coming in for months at a time, and then all of a sudden 20 the payment would stop. But then they would look out their back 21 door, and they would see a pump jack pumping, and they would see 22 a gas meter hissing with the gas flowing through it, and they 23 weren't getting paid. And many of them became very concerned, 24 you know: Why one month I get paid and the next month I don't 25 get paid.</p>
Page 1777	Page 1779
<p>1 transportation companies, and gas pipeline companies that 2 transport gas, to verify production. 3 Q. What is a run ticket? 4 A. Run ticket? 5 Q. Yeah, what is it? 6 MR. KIRSCHMAN: Your Honor, objection. Outside the 7 scope of this case. This is asset management. This is talking 8 about what private companies do. This is not about a historical 9 accounting. 10 THE COURT: Well -- 11 MR. GINGOLD: Your Honor, may I? 12 THE COURT: No, we touched on this yesterday. I don't 13 want to overdo this. I mean, you're right that this is, going 14 forward, an asset management more than it is historical 15 accounting, but frankly, it helps for me to kind of fill in the 16 picture of what is known and what is not known, and what can be 17 verified and what can't be verified. So a reasonable amount of 18 this, I'm going to allow. 19 Go ahead. 20 MR. KIRSCHMAN: Thank you, Your Honor. 21 BY MR. GINGOLD: 22 Q. What is a run ticket, Mr. Gambrell? 23 A. A run ticket is a statement that is often signed by a 24 transporter and an operator when oil leaves a tank. What they 25 do is, they measure the oil in the tank when it's full, and then</p>	<p>1 And so under those conditions, a group of individuals 2 got together and filed a lawsuit against Department of Interior. 3 And what they discovered was that it was completely without any 4 type of analysis or any type of inspection, enforcement, or 5 auditing, or any type of review of what was going on in the 6 Navajo and some of the unit allotted areas in the Four Corners. 7 There was no review. 8 And so, under a consent decree in 1995, 1996, that time 9 period, they agreed that they would create an office that would 10 have all the bureaus within that office, with one director, and 11 that they would do everything from answering questions when 12 landowners walked in the door: "Where are my royalties? Why am 13 I getting paid low? Why is my land -- why are they drilling 14 next to my land"; to what I call the fiduciary responsibilities 15 of auditing, inspection and enforcement, leasing oil and gas 16 properties, cancelling leases, bonds, and so forth. 17 Q. With respect to your responsibilities, you described 18 auditing. Correct? 19 A. Yes. 20 Q. What type of audit, if any, did you do? 21 A. We did extensive oil and gas audits, in which we looked at 22 everything within the contracts of a lease dealing with volumes 23 and values. 24 Q. Why was that important? 25 A. Well, you know, the honor system doesn't work. Put it that</p>

5 (Pages 1776 to 1779)

Page 1780	Page 1782
<p>1 way. We found that companies often underpaid royalties. And so</p> <p>2 any time we did an audit, we always recovered additional monies.</p> <p>3 In fact, when I look at the time period -- we did an</p> <p>4 analysis. In the five years of existence of FIMO, we collected</p> <p>5 seven times the underpaid royalty that MMS collected 20 years</p> <p>6 prior to FIMO's existence. So audits were very critical.</p> <p>7 Q. But wasn't MMS performing audits on a regular basis prior to</p> <p>8 the creation of FIMO?</p> <p>9 A. No, MMS was not creating audits, was not doing audits before</p> <p>10 FIMO, or very, very few.</p> <p>11 Q. Was MMS regularly involved in the auditing procedures</p> <p>12 outside of the FIMO jurisdiction after FIMO was created?</p> <p>13 A. When we took over the office and I hired auditors, MMS would</p> <p>14 basically review our work and check to see if we were doing it</p> <p>15 correctly.</p> <p>16 Q. But did MMS generally audit oil and gas leases and mineral</p> <p>17 leases independent of what FIMO was doing?</p> <p>18 A. They did do audits. Over time, their auditing actually</p> <p>19 became less and less. They started doing just compliance</p> <p>20 reviews. We continued to do audits.</p> <p>21 Q. I would like to ask you a question, and I would like to turn</p> <p>22 to the defendant's Accounting Standards Manual. The Bates</p> <p>23 number is 44-1, and I would like to turn to page eight.</p> <p>24 If we can just look at the top of this page first.</p> <p>25 You've seen this document before, haven't you, Mr. Gambrell?</p>	<p>1 Let's stick with the first sentence. Is it your</p> <p>2 understanding that the Minerals Management Service conducts</p> <p>3 periodic audits of oil and gas producers?</p> <p>4 A. Today, MMS does compliance reviews. They do not do audits.</p> <p>5 Q. What is the difference between a compliance review and an</p> <p>6 audit?</p> <p>7 A. A compliance review is looking at what we call, for example,</p> <p>8 an expected price that's in the marketplace. And you look to</p> <p>9 see if a company pricing structure, their price is equal to that</p> <p>10 price.</p> <p>11 An audit is looking at the gross proceeds. It's going</p> <p>12 into the company documents and looking at contracts, and</p> <p>13 actually doing the work of an auditor, reviewing: Did they pay</p> <p>14 correctly? Did they take deductions they should not have taken?</p> <p>15 Were the volumes correct? All those type of issues like that.</p> <p>16 It's really looking into the details.</p> <p>17 Q. And that's what you did at the FIMO office. Correct?</p> <p>18 A. Right.</p> <p>19 Q. And what you are testifying to today is, that's not what MMS</p> <p>20 is doing. Correct?</p> <p>21 A. That is not what MMS is doing today.</p> <p>22 MR. KIRSCHMAN: Objection, Your Honor. Lack of</p> <p>23 foundation.</p> <p>24 THE COURT: How do you know that?</p> <p>25 BY MR. GINGOLD:</p>
Page 1781	Page 1783
<p>1 A. Yes, I have.</p> <p>2 Q. And as you see, this is entitled "Scope definitions." And</p> <p>3 this is the Accounting Standards Manual provided to this Court</p> <p>4 in support of the historical trust accounting, and it states,</p> <p>5 "For the purposes of the historical accounting, certain scope</p> <p>6 definitions will be necessary. The table below identifies the</p> <p>7 key definitions made."</p> <p>8 Do you see that, Mr. Gambrell?</p> <p>9 A. Yes, I do.</p> <p>10 Q. I would like to turn your attention to the scope definitions</p> <p>11 that are highlighted on this page. And those are definitions</p> <p>12 number two and three. If you will note with regard to scope</p> <p>13 definition two, the Accounting Standards Manual states, "Oil and</p> <p>14 gas sales reports received from the lessee will not be verified</p> <p>15 against production documents."</p> <p>16 What is your understanding of what that means?</p> <p>17 A. Well, what they're saying is that they will not verify it</p> <p>18 against run tickets or transportation statements, anything like</p> <p>19 that, is my understanding.</p> <p>20 Q. Is that in any way related to income, Trust income produced</p> <p>21 to beneficiaries?</p> <p>22 A. It has everything to do with income, in the end.</p> <p>23 Q. Now, there's an explanation in the column on the right, and</p> <p>24 it states, "The Minerals Management Service conducts periodic</p> <p>25 audits of oil and gas producers."</p>	<p>1 Q. How do you know they're not doing it, Mr. Gambrell?</p> <p>2 A. There are many reports that have come out recently from the</p> <p>3 IG, and also my working still with state and Tribal auditors.</p> <p>4 And as we discuss it, we all agree that these are not audits.</p> <p>5 Q. Did you have any discussions with MMS personnel with regard</p> <p>6 to the audits?</p> <p>7 A. I still talk to MMS personnel.</p> <p>8 MR. KIRSCHMAN: Objection, Your Honor. Hearsay.</p> <p>9 THE COURT: Well, I'm going to allow that. I mean, it</p> <p>10 goes to weight. He's premising this on official reports,</p> <p>11 statements from people. It is hearsay.</p> <p>12 Let's put it this way, Mr. Kirschman: It may not prove</p> <p>13 anything, but it raises questions.</p> <p>14 Go ahead.</p> <p>15 BY MR. GINGOLD:</p> <p>16 Q. When you were the head of the FIMO office, did you have</p> <p>17 meetings with MMS concerning the nature and scope of the audits?</p> <p>18 A. Yes, we did. Talked about our audit plans, what we were</p> <p>19 doing, how we would approach it.</p> <p>20 Q. Did you have any discussions with MMS about how MMS was</p> <p>21 approaching the audits?</p> <p>22 A. Yes, we met with other audit teams, and we noticed that they</p> <p>23 were doing things that we weren't doing in the FIMO office.</p> <p>24 They were approaching a lease audit not as an audit, but as a</p> <p>25 review.</p>

Page 1784	Page 1786
<p>1 Q. Did you raise questions about the effectiveness of that 2 audit with any MMS personnel? 3 A. I raised questions about the effectiveness, and I presented 4 evidence to show that doing the audit approach, I collected 5 eight times the dollar amount that they were doing using the 6 lease review approach. 7 Q. Did MMS change its procedure based on what you reported as 8 to the results of your audit process? 9 A. No, they did not. 10 Q. Do you know why? 11 A. There was an objective, a GPRA, government goal, the goals 12 for government accounting, that was put in place under the 13 current administration, to get rid of all the backlog of audits 14 that were sitting out there and had not been completed. And 15 that was where MMS changed their process from an audit to a 16 review, and closed. 17 Q. Do you know what the backlog was? 18 A. There were thousands of Indian allotment audits that were 19 incomplete that were basically closed without audit. 20 Q. Did you raise any concerns with MMS or anyone at Interior 21 about that procedure? 22 A. I blew the whistle on MMS for fast-tracking the audit 23 approach. I had witnesses that witnessed my discussions with 24 MMS management, in which MMS told me not to document industry 25 discussions, to fast-track audit approaches using illegal</p>	<p>1 that that price is based on. 2 Now, we have an example back in 1999, a huge qui tam 3 settlement. It was around \$460 million. I think it was 11 4 major oil companies came into the federal government and said, 5 "How do we settle for falsifying prices in the field? We know 6 that industry has falsified prices in the past, and we know that 7 we cannot trust a price that is on a royalty report, that we 8 have to go and look at gross proceeds and look at contracts and 9 look at source documents behind those prices." 10 But in today's MMS system, they do not look at contract 11 prices, they look at bulletin prices that are created by 12 industry. 13 Q. And your audits at FIMO would reveal that information. 14 Correct? 15 A. Yes. In fact, I did a comparison of the bump method on a 16 number of occasions to a full-blown audit. And the bump method 17 takes about -- I could get an auditor to do that in about 18 20 hours on one particular oil and gas lease. But a full-blown 19 audit takes about 600 hours. 20 But when I did the comparison, what I found was that we 21 collected eight times the amount of money that was derived from 22 the bump method, using a full-blown audit. 23 Q. I would like -- the second sentence of reference number two 24 with regard to scope definitions states that "These audits 25 include verification of actual production against that</p>
Page 1785	Page 1787
<p>1 methods, and to close all backlog audits. 2 Q. What illegal methods are you referring to? 3 MR. KIRSCHMAN: Objection. Lack of foundation. Asking 4 for legal opinions. 5 THE COURT: Well, I think we can get much more 6 specific. "I blew the whistle on MMS for fast tracking. I had 7 a witness that witnessed my discussions with management." 8 What discussions, with whom, and when? 9 THE WITNESS: I had discussions with Teresa Bayani and 10 Debbie Gibbs-Tshody regarding valuation methods on Indian lands, 11 and I was told to use a method called the "bump method." 12 A bump method is a valuation of gas in which you look 13 at -- an Mcf of gas has 1,000 BTUs if it's almost a pure 14 methane. 15 BY MR. GINGOLD: 16 Q. Did you say Mcf of gas? 17 A. Mcf. 1,000 cubic feet of gas. 18 If the gas quality is a higher quality, say it's 19 1,800 btu, that gas stream, that gas has liquids within that gas 20 stream. And those liquids have additional value. 21 And so we raise the value, or we raise the price, and 22 bump it to get that additional value. The problem with that 23 kind of analysis is that it fails to look into the actual price, 24 which may or may not be true. So you're depending on a price 25 the company reports, but you're not looking at the contracts</p>	<p>1 reported." 2 This is the MMS audits now, not the FIMO audits. Is it 3 your understanding that that statement is true? 4 A. That statement is completely false. MMS does not do 5 production verification at all. That is not their duty or 6 responsibility. There is no oil and gas auditor within MMS that 7 works onshore and does production verification. 8 Q. So you distinguish onshore from offshore. Correct? 9 A. Yes, I do. 10 Q. Are there individual Indian leases offshore? 11 A. There are no individual Indian leases offshore. 12 Q. And it's your understanding, based on your work at FIMO and 13 your work with MMS officials, that that verification is done for 14 the offshore leases. Correct? 15 A. It is done for offshore. 16 Q. I would like to turn your attention to reference number two 17 within the scope definitions -- or number three, I'm sorry. 18 Reference number three states, "The prices received for oil, 19 gas, and other minerals will not be analyzed as part of the 20 historical accounting." 21 Do you see that, Mr. Gambrell? 22 A. Yes, I do. 23 Q. Do you know whether or not, based on your experience, the 24 prices received for oil, gas, and other minerals are related to 25 the income for Individual Indian Trust beneficiaries?</p>

7 (Pages 1784 to 1787)

Page 1788	Page 1790
<p>1 A. The incomes are totally dependent upon price.</p> <p>2 Q. Now, the explanation is in the column immediately adjacent</p> <p>3 to this. And it states, "Currently, MMS conducts a product</p> <p>4 verification process in which it determines that prices received</p> <p>5 are reasonable in relation to the marketplace."</p> <p>6 When you were the head of FIMO, did MMS conduct such a</p> <p>7 product verification process?</p> <p>8 A. They did not do this type of a process. Again, if you want</p> <p>9 to verify prices, as I said, you have to look at the gross</p> <p>10 proceeds, the contracts, what is being paid by the companies.</p> <p>11 It's not looking at a price, an index price or a posting, it's</p> <p>12 looking at: What is the gross proceeds price, based on contract</p> <p>13 source documents.</p> <p>14 Q. Now, does that in any way relate to periodic payments made</p> <p>15 by the oil companies?</p> <p>16 A. It relates to all payments made by oil and gas companies.</p> <p>17 Q. If you can describe the payment process from the beginning</p> <p>18 of a payment through the distribution to address beneficiary, it</p> <p>19 would be helpful.</p> <p>20 A. The way a payment comes in to the individual Indian mineral</p> <p>21 owners is based on the initial lease instrument. The lease</p> <p>22 instrument, one, sets the royalty rate. Once you have</p> <p>23 established a royalty rate, you then have to go through the</p> <p>24 process of looking at: Is it commingled with other leases in a</p> <p>25 unit agreement; is it commingled in other formations within the</p>	<p>1 lease or situation is?</p> <p>2 A. A commingled situation can be either above the ground or</p> <p>3 below the ground, depending on the type of well and the type of</p> <p>4 oil and gas build.</p> <p>5 In a below-the-ground situation, we might have a well</p> <p>6 location that has horizontal drilling, and it may have laterals</p> <p>7 that shoot off in different directions and take production from</p> <p>8 multiple types of land such as state, federal, Indian.</p> <p>9 And when we have that situation, we have one well</p> <p>10 that's producing from multiple properties using horizontal</p> <p>11 drilling. We have to figure out, what is the production --</p> <p>12 using engineering, what is the production that's coming from</p> <p>13 Indian versus what is the production coming from the federal.</p> <p>14 And so we have to know, what are those figures? What is that</p> <p>15 detail that the allocation should be based on?</p> <p>16 The above-ground stuff that we look at is with regard</p> <p>17 to off-lease measurement. When you deal with large oil and gas</p> <p>18 basins like the San Juan basin, you have multiple wells that</p> <p>19 actually go into one measurement point. That measurement point</p> <p>20 is basically the transfer or the sale point, transfer of title.</p> <p>21 At that point we need to know: What is the allocation</p> <p>22 back to that federal property, that Indian property, and that</p> <p>23 state property, and that private property? So we have to know</p> <p>24 exactly, based on allocations and testing, well meters and</p> <p>25 off-lease measurement meters, the exact volumes that are going</p>
Page 1789	Page 1791
<p>1 oil and gas pulling zone; is there off-lease measurement that</p> <p>2 was approved by BLM which commingles federal, Indian, state, and</p> <p>3 private leases?</p> <p>4 Once you get past the stage of figuring out how it's</p> <p>5 allocated past the wellhead, off the lease, then you can</p> <p>6 determine the value and the monies going through the system</p> <p>7 properly to the ownership level.</p> <p>8 Once you get to the ownership level, you have to look</p> <p>9 at: Are the probates backing up the decision for that owner to</p> <p>10 be part of that allotment; is there a gift deed out there; is</p> <p>11 there a life estate; are there supervised accounts; are there</p> <p>12 special accounts that are made to pay certain expenses?</p> <p>13 And so you have to look at it at that point, too, at</p> <p>14 the probate level, to find out, did the payment go all the way</p> <p>15 through. And then once you do that, if you really want to</p> <p>16 verify, you look at canceled checks to see if the money actually</p> <p>17 went out to the landowners.</p> <p>18 Q. Are you saying this is what FIMO did on a regular basis?</p> <p>19 A. Yes, we did.</p> <p>20 Q. Do you know whether MMS does that?</p> <p>21 A. MMS does not do this. Because of our special situation,</p> <p>22 having all the bureaus within our office, and the authorities,</p> <p>23 we could do verification from the beginning of the lease to the</p> <p>24 actual payment to the landowner.</p> <p>25 Q. If we're dealing with -- could you explain what a commingled</p>	<p>1 through and being sold.</p> <p>2 Once we know that, we can determine that the landowners</p> <p>3 are getting paid correctly.</p> <p>4 Q. Now, is that subsequent to either a wire transfer or deposit</p> <p>5 made to the Treasury?</p> <p>6 A. It is subsequent to that, yes.</p> <p>7 Q. Okay. From a process, step-by-step basis, the first step is</p> <p>8 what?</p> <p>9 A. The first step is to determine: What is the allocation?</p> <p>10 Q. That's after the deposit is made into Treasury?</p> <p>11 A. That is before the deposit is made.</p> <p>12 Q. Okay. After the deposit is made into Treasury, what is</p> <p>13 necessary to be --</p> <p>14 A. Once a deposit is made into Treasury - and this is for</p> <p>15 Department of Interior type lands, this is not private - the</p> <p>16 money goes into the Treasury, and then it is sent from MMS. If</p> <p>17 MMS can back it up with royalty reports and production reports,</p> <p>18 it is sent from MMS, and it's broken down to the lease level and</p> <p>19 sent to the BIA splitter file in OTFM.</p> <p>20 THE COURT: BIA what file?</p> <p>21 THE WITNESS: Splitter file.</p> <p>22 A. And then they split out the ownership based on their</p> <p>23 databases that have information that pertains to probates, life</p> <p>24 estates, gift deeds, and other types of information. And then</p> <p>25 that payment finally makes it to the landowner after that.</p>

Page 1792	Page 1794
<p>1 BY MR. GINGOLD: 2 Q. So the information is among -- if funds are allocated to 3 Trust beneficiaries after the deposited is into Treasury, the 4 type of information that you said that is in the splitter file 5 will help determine how the allocations are made. Is that 6 correct? 7 A. That is correct. 8 Q. And from that information, the large deposit will be broken 9 up between whom? 10 A. For example, Texaco would make a deposit of, say \$5 million; 11 that would be for 700 leases. Then that payment would go 12 through the system on the lease basis, and they would break out 13 what is Indian, what is federal, at MMS. 14 It then goes to the Office of Trust Funds Management in 15 BIA, and then they break it out to all the individuals based on 16 their allotment within that lease. 17 Sometimes there are leases that have multiple 18 allotments, sometimes there are leases that have one allotment. 19 But you have to figure out, you know, what does a lease contain, 20 what is this allocation? 21 Q. At FIMO, did you verify whether or not the allocations were 22 correct? 23 A. We verified allocation all the time. It was an ongoing 24 requirement if you wanted to get payment out correctly. When we 25 deal with -- in any place that has any units or other types of</p>	<p>1 allocations? 2 A. Often it wasn't. We went right back to the source 3 documents. We went right back to the exhibit, or we used other 4 types of data from other companies. 5 Q. What about the IRMS database? Did you rely on that to 6 ensure the allocations were correct? 7 A. Not always. We would look at -- we would go back to the 8 actual probates, to see what came out of the court order for 9 those distributions. And sometimes we found that what was on 10 the court order did not match what was electronically 11 distributed to the landowners. 12 Q. When you found a problem, what did you do? 13 A. We would notify Office of Trust Funds Management that there 14 was an incorrect distribution that wasn't following the order. 15 Q. And was the posting in the IRMS database corrected, do you 16 know? 17 A. If we notified them and provided them with evidence, they 18 would correct it. 19 Q. Do you know if MMS also undertook that same procedure to 20 ensure that the posting was correct? 21 A. I'm not sure if they did. 22 Q. Now, did you use any alternative databases to measure the 23 accuracy of allocations or production? 24 A. Yes, we did. We actually purchased -- when I went to work 25 at FIMO, we purchased the IHS Dwight's database to do our</p>
Page 1793	Page 1795
<p>1 agreements or commingling, even on private land, you have to 2 verify your allocations on a continual basis. You have to keep 3 looking to see: Is there correct allocations, are they using 4 the source documents to allocate? 5 In some cases we've seen -- well, in a particular unit, 6 the biggest unit in the San Juan Basin called the Gallegos 7 Canyon Unit, there was a lot of difficulty with the allocations. 8 Because BLM had approved multiple operators on one unit, and 9 they were actually conflicting in their allocations to the 10 different types of ownership, land ownership. 11 And so, for several years we had Indian landowners that 12 were not getting paid because they were allocating -- what 13 should have gone to the Indian landowner, they were allocating 14 it to a federal lease. 15 Q. And this was after the deposit of the Trust revenue was made 16 into the Treasury. Correct? 17 A. Yes, that is correct. 18 Q. Did you yourself, when you were at FIMO, identify allocation 19 problems after the deposit was made at Treasury? 20 A. We identified many allocation problems after the deposit was 21 made. A lot of the stuff is looking back in retrospect to find 22 out, you know, did they perform according to the agreements? 23 And often we found that companies, they misallocated or they 24 just didn't perform correctly. They missed their allocations. 25 Q. And was the MMS database helpful in determining the</p>	<p>1 production analysis, because we did not trust BLM/MMS production 2 databases. 3 Q. Did you inform your superiors that you did that? 4 A. Yes, I did. 5 Q. Was there any reaction to that? 6 A. They were in favor of me using a system that was more 7 reliable. 8 Q. Do you know whether or not -- you indicated when you're 9 dealing with I think commingled and unitized leases, that states 10 and tribes and others might also be involved. Is that correct? 11 A. Yeah, I was very much involved with the state Tribal audit 12 group, which included all the tribes and states that had a 13 contractual agreement with MMS to do audits. And within our 14 group, most of us had other databases that we purchased to rely 15 on to verify production and royalties. 16 Q. So based on your understanding, the states also did not rely 17 on the MMS database? 18 MR. KIRSCHMAN: Objection. Lack of foundation, 19 hearsay. 20 THE COURT: Sustained. 21 BY MR. GINGOLD: 22 Q. Did you work with the states and tribes and others whose 23 lands were part of the communitized and unitized leases? 24 A. Yes, we did. 25 Q. Why did you do that?</p>

Page 1796	Page 1798
<p>1 A. We had leases that were communitized or unitized with state 2 leases, like state of New Mexico or state of Utah, and so we 3 would work with the state auditors. 4 Q. Why did you need to work with the state auditors? 5 A. We needed to find out if their data was equivalent to our 6 data. If there was an allocation problem, we wanted to make 7 sure that what they were getting and ended up with the numbers 8 they came up with made sense, and could reconcile with our 9 numbers. 10 Q. Was that considered an important part of the process that 11 you were involved in, in determining whether or not allocations 12 were correct? 13 A. Yes, it is. 14 Q. And you did that on a regular basis. Correct? 15 A. Yes. 16 Q. Now, do you know what databases that the states relied on, 17 for example? 18 A. A lot of times the states rely on their own royalty 19 reporting system within the state, and they relied on IHS 20 Dwight's database. 21 Q. Do you know if MMS itself in any way relied on the 22 PI/Dwight's database? 23 A. MMS, BLM, and BIA all use the IHS Dwight's database for 24 doing economic analysis. 25 Q. Economic analysis for what?</p>	<p>1 over time. They are databases that you can trust, that are 2 purposely made for industry to do exploration and development, 3 and to figure out decline curves and economic reserves. And 4 they're the best data we have. 5 Q. Now, you said you used that database with regard to 6 allocating -- confirming the correct allocations for Individual 7 Indian Trust beneficiaries. Correct? 8 A. Yes, we do. 9 Q. Did MMS use that database with regard to Individual Indian 10 Trust lands? 11 A. I have never heard of anybody within the Indian compliance 12 audit programs using IHS databases, except for FIMO. 13 Q. Did you ever recommend that MMS do that? 14 A. Yes, I did. 15 Q. Did you recommend that BLM do that? 16 A. Yes. 17 Q. Did you recommend that BIA do that? 18 A. Yes, I did. 19 Q. What was the response? 20 A. There was a lot of resistance. When I first brought in the 21 IHS database, the BLM manager relied on a lot of manual systems 22 that were used prior. They used a system called ALMRS, which 23 was very unreliable, and he felt that that was sufficient. 24 I knew that it wasn't sufficient, and found many 25 problems with ALMRS, and so we went straight to the IHS database</p>
Page 1797	Page 1799
<p>1 A. For any type of onshore/offshore type development. Looking 2 at things from developing new oil and gas builds to looking at 3 the decline curves related to different types of oil and gas 4 properties. 5 And so any time you do any kind of economic or reserve 6 analysis, you would go to the Dwight's database. 7 Q. You would go to the Dwight's database and not the MMS 8 database? 9 A. Yes. 10 MR. KIRSCHMAN: Your Honor, if I could make one last 11 continuing objection that this is asset management in gross 12 detail now, and outside, therefore, the scope of this hearing. 13 THE COURT: Gross detail? 14 MR. KIRSCHMAN: Yes. Your Honor suggested a topic 15 overview was of assistance -- 16 THE COURT: Yes. You may have your continuing 17 objection. 18 MR. GINGOLD: Thank you, Your Honor. 19 BY MR. GINGOLD: 20 Q. Do you know why MMS itself acquired the PI/Dwight's database 21 to rely on for purposes of its drilling and other type of 22 analysis? 23 A. The reason they acquired those databases, and I'm talking 24 about all three agencies, was because those production databases 25 are very reliable for determining volumes and depletion curves</p>	<p>1 and spent the money to use it to verify production. 2 Q. You said ALMRS. Is that the acronym for A-L-M-R-S? Is that 3 what that is? 4 A. That is correct. 5 Q. And which bureau used that system? 6 A. That was a system used by the Bureau of Land Management. 7 And it was a system used to track all unit agreements, lease 8 agreements, everything to do with oil and gas properties. 9 Q. Did you view that as a reliable system? 10 A. I did not review that as a reliable system. And in fact, 11 what happened was, after I arrived, within a couple of years, 12 the Department of Interior basically shelved the system because 13 it was a complete failure, and they said that it cost around 14 \$450 million, and it was a UNIX operating system that did not 15 work. 16 Q. Was the data in the system accurate or complete, do you 17 know? 18 A. The data was not accurate, and it was not complete. 19 Q. What about the systems used by MMS at the time you were at 20 FIMO? 21 A. In the time I was at FIMO, MMS went from a system that was 22 internally designed and developed to a system designed by a 23 company called Accenture. And that system was -- the old 24 system -- in October of 2001, was the first date that they 25 actually tested -- or they ran the system.</p>

Page 1800	Page 1802
<p>1 The old system was shut off at the end of September, 2 and the new system was turned on in October. When that system 3 was turned on, we had about a 75 percent failure rate in the 4 amount of royalties actually paid out to the allottees. 5 Q. And was this with regard to funds that had been collected 6 and the payments were affected. Is that correct? 7 A. Yes, it was. 8 Q. How did that happen? 9 A. It was a new system, never tested. The director made the 10 decision not to parallel-test both systems at the same time. 11 When the Accenture system was turned on, it just did not work. 12 Production reports were not coming in, royalty reports were not 13 coming in. The money was getting to the system, but the 14 information to reconcile the monies and get it out to the leases 15 did not go out correctly. 16 To this day, in talking to my auditors that used to 17 work for me, they still have not reconciled many of those 18 numbers. 19 THE COURT: Okay. Mr. Gingold, we are getting off into 20 a very generalized admixture of hearsay, expertise, I don't know 21 what-all. This is all very interesting, but I think I'm about 22 through with this line of questioning. I hope you are. 23 MR. GINGOLD: I understand, Your Honor. This is only 24 with respect to the fact that MMS information was excluded from 25 the scope of the accounting.</p>	<p>1 THE COURT: Director of what? 2 THE WITNESS: Director of MRM, Mineral Revenue 3 Management. 4 THE COURT: All right. Within what? 5 THE WITNESS: Within the Mineral Management Services. 6 It's the royalty collection. 7 THE COURT: So the associate director of Mineral -- 8 THE WITNESS: Mineral Revenue Management Services. 9 THE COURT: Mineral Revenue Management Services, within 10 MMS. Lucy? 11 THE WITNESS: Q-E-R-Q-E-S -- Q-U-E-R-Q-E-S, I'm sorry. 12 THE COURT: So let's go with the Accenture program, 13 let's not run parallel testing. Is that your testimony? 14 THE WITNESS: Yes, it is. 15 THE COURT: When was that? 16 THE WITNESS: That was in October of 2001. 17 THE COURT: October of 2001? 18 THE WITNESS: Uh-huh. 19 THE COURT: All right. The Accenture program was going 20 to do what, again? 21 THE WITNESS: The Accenture program was to get the 22 monies from the payment by the companies, through the MMS 23 system, to -- out to the BIA systems. It was the royalty 24 compliance system. 25 THE COURT: All right. And you say this program cost</p>
Page 1801	Page 1803
<p>1 THE COURT: I know. But so far I just have the 2 director and it was excluded. And I don't know when, I don't 3 know what director, I don't have any details. There's nothing 4 probative about this at all. It's at such a high level of 5 generality that I can't make any use of it. 6 BY MR. GINGOLD: 7 Q. Let's go into the specific details, Mr. Gambrell. You were 8 the head of FIMO during what period of time? 9 A. Yes. 10 Q. What period of time were you the head of FIMO, what years? 11 THE COURT: We got that. What director refused to run 12 parallel testing with the Accenture program? What was the 13 Accenture program? What was the time frame of that refusal? 14 What MMS payments were lost? What happened to them after they 15 were lost? 16 If you want to throw those sorts of generalities out, 17 Mr. Gingold, they've got to be specific and precise. 18 MR. GINGOLD: I was going to do that, but I was trying 19 to avoid leading questions, Your Honor. 20 THE COURT: I have just asked all the questions. What 21 are the answers? 22 MR. GINGOLD: Thank you. 23 BY MR. GINGOLD: 24 Q. Which director refused? 25 A. It was the associate director, Lucy Querques.</p>	<p>1 \$450 million? 2 MR. GINGOLD: That was the ALMRS system, Your Honor. 3 THE COURT: Oh, ALMRS cost \$450 million. Accenture, is 4 that the consulting arm of what used to be Arthur Andersen? 5 MR. GINGOLD: Andersen Consulting, Your Honor. 6 THE COURT: Andersen Consulting, okay. And no parallel 7 testing -- parallel with what? 8 THE WITNESS: Well, Your Honor, when you turn on a new 9 system, you want to be able -- you want to make sure that that 10 system is working against the old system. 11 THE COURT: I know. But that's my question. What old 12 system was it supposed to parallel with? 13 THE WITNESS: There was a system in place that did the 14 distributions and allocations according to the leases that came 15 into the MMS system that was already in use. The Accenture 16 system was a new system. 17 THE COURT: I know. But was the old system an 18 automated system, was it a computer system? What was it called? 19 THE WITNESS: It was a computer system, and I think it 20 was just called the compliance system. 21 THE COURT: All right. So that was turned off, and the 22 Accenture system was turned on sometime in 2001. And the 23 Accenture system didn't work? 24 THE WITNESS: Yes. 25 THE COURT: And then what happened?</p>

11 (Pages 1800 to 1803)

Page 1804	Page 1806
<p>1 THE WITNESS: And then the individual Indian mineral 2 owners did not get paid. 3 THE COURT: When, and for how long? 4 THE WITNESS: From October until June. 5 BY MR. GINGOLD: 6 Q. October of what year? 7 A. October of 2001 until about June of 2002. And to this day, 8 some of those accounts have not been reconciled. 9 THE COURT: Some of them have not been, many of them 10 have been. Would that be accurate? Or do you know? 11 THE WITNESS: I don't know. 12 THE COURT: Okay. Go ahead, Mr. Gingold. 13 MR. GINGOLD: Thank you. 14 BY MR. GINGOLD: 15 Q. With respect to the ALMRS system, how did that relate to the 16 payment to Individual Indian Trust beneficiaries of funds that 17 had been collected and deposited in the Treasury? 18 A. MMS relied on BLM data. BLM data within the ALMRS system 19 had to do with allocations of leases for commingling, off-lease 20 measurement, and unit agreements. 21 The ALMRS system was not allocating correctly, and the 22 lease was off -- the data was often incomplete, so that when MMS 23 would contact a BLM person and ask for an allocation figure, 24 that figure was often wrong. 25 Q. And if the figure was wrong, what was the --</p>	<p>1 rumor? 2 BY MR. GINGOLD: 3 Q. First of all, how much money do you know went through the 4 FIMO office with regard to minerals and oil and gas payments to 5 individual Indians on an annual basis? 6 A. About \$6 million. 7 Q. And that includes coal, as well? 8 A. If you add the coal in, it's about seven and a half million. 9 Q. Now, do you know how many of the Trust beneficiaries whose 10 accounts are within the jurisdiction of the FIMO office would be 11 affected by any failure at ALMRS or Accenture systems? 12 A. Everybody, every account holder would be affected. 13 Q. And why is that? Why would everyone be affected? Is it 14 because of the unitized and communitized lease situation? 15 MR. KIRSCHMAN: Objection. Leading. 16 THE COURT: Sustained. 17 BY MR. GINGOLD: 18 Q. Why would everyone be affected? 19 A. Because any type of distribution of payments is dependent 20 upon those systems' allocation information. 21 Q. But could the data have only been wrong with respect to a 22 particular individual, and therefore most of the individuals 23 wouldn't be affected by the problems that you're discussing? 24 A. The data could be wrong with a particular individual, or it 25 could be wrong systematically.</p>
Page 1805	Page 1807
<p>1 MR. GINGOLD: I'm sorry, Your Honor. 2 THE COURT: Often wrong? You know, it's just -- 3 actually, what we're developing here is a serious foundational 4 problem for all this testimony. 5 BY MR. GINGOLD: 6 Q. We're dealing with Individual Indian Trust data, are we not? 7 A. Yes. 8 Q. And we're dealing with Individual Indian Trust data that was 9 housed in the ALMRS system. Correct? 10 A. Yes. 11 Q. And are we dealing with Individual Indian Trust data that 12 was housed in the Accenture system? 13 A. Yes. 14 Q. And how does that relate to the posting to an individual's 15 account, the amount of money that is to be distributed to a 16 particular beneficiary? 17 A. It's a dependency thing, in the sense that when you make a 18 payment to an individual Indian, you have to go back to the MMS 19 and BLM systems to get correct allocations. 20 THE COURT: Mr. Gingold, that's not what I'm 21 complaining about. He said the ALMRS system was "not allocating 22 correctly," the data was "often incomplete," the figure was 23 "often wrong." 24 What does "often" mean? You know: When, how many, how 25 does he know? What hands did he have on this process? Is this</p>	<p>1 Q. Did you know whether it was systemic or on an individual 2 basis? 3 A. Well, we often knew if it was systemic, because we had many 4 landowners come in and complain. And then we would do an 5 analysis, and we would find that yes, it was a systemic error. 6 THE COURT: What was the systemic error? Who is the 7 "we" in that sentence? 8 THE WITNESS: FIMO. My employees, myself. 9 BY MR. GINGOLD: 10 Q. Which employees? 11 A. My auditor staff. 12 Q. How did you make that determination? 13 A. We would look back to see what payments actually went 14 through the system, and what were some of the problems. For 15 example, we would have an oil and gas company that just failed 16 to report, and the landowners would come in and say, "We didn't 17 get our check." 18 We would go back and look, and we would see that there 19 was some kind of a problem with the reporting information, that 20 it did not make it through the system, and so the payment could 21 not go out to IIM. 22 Q. Was that a situation where payment wasn't made, or was that 23 a situation where payment was made and the funds that were 24 deposited weren't paid to a Trust beneficiary? 25 A. It could be either way. It could be a payment wasn't made,</p>

Page 1808	Page 1810
<p>1 or it could be there was a reporting problem and the money is</p> <p>2 basically sitting in an MMS Treasury account until that</p> <p>3 reporting problem is corrected.</p> <p>4 Q. And you're thinking of a particular example. Was that</p> <p>5 example just with respect to one Trust beneficiary?</p> <p>6 A. No, there's many examples of that.</p> <p>7 Q. There's many examples of the fact that money was sitting in</p> <p>8 Treasury?</p> <p>9 A. Uh-huh.</p> <p>10 Q. It wasn't allocated and it wasn't posted to an individual's</p> <p>11 account and paid to the beneficiary. Is that what you're</p> <p>12 saying?</p> <p>13 A. Yes.</p> <p>14 THE COURT: And do you have all those examples with you</p> <p>15 here?</p> <p>16 THE WITNESS: I have some examples, not in the</p> <p>17 courtroom, but on my computer where I have actually done some</p> <p>18 analysis.</p> <p>19 THE COURT: Let's move on, Mr. Gingold.</p> <p>20 BY MR. GINGOLD:</p> <p>21 Q. When you were going through the process to ensure that</p> <p>22 individuals were being paid, did you determine whether or not</p> <p>23 the information posted on the IRMS system was accurate and</p> <p>24 complete with regard to Individual Indian Trust beneficiaries?</p> <p>25 A. We did what we could in terms of looking at probate orders,</p>	<p>1 A. No, there are several examples.</p> <p>2 Q. With regard to the accuracy of the information posted on the</p> <p>3 IRMS system for an individual, what was the relationship to the</p> <p>4 allocation that was done prior to the posting, do you know? For</p> <p>5 example, was the accuracy of the posting dependent on the</p> <p>6 accuracy of the allocation?</p> <p>7 A. When it comes to the IRMS system, the accuracy of the</p> <p>8 posting is dependent upon only the portion that deals with the</p> <p>9 individual ownership. It is not dependent upon the allocations</p> <p>10 at the lease or the units or within MMS, their systems.</p> <p>11 Q. Could you explain that?</p> <p>12 A. It's kind of like, if you were to look at the IIM system and</p> <p>13 you were to do a test and say, "Okay, the payment that's going</p> <p>14 out, does it meet a lot of the hard copy documents?" Yes, that</p> <p>15 may be true. It does actually fit within those documents, and</p> <p>16 it's backed up by the probates.</p> <p>17 Does that mean that it paid out correctly to the</p> <p>18 individuals? It does not mean that. It only means that the</p> <p>19 ownership may be correct, and that the payment that went out is</p> <p>20 based on that ownership record.</p> <p>21 Q. And I think in the early part of your testimony you</p> <p>22 explained the documents you need to look at in order to</p> <p>23 determine whether or not, and correct me if I'm mistaken, the</p> <p>24 posting and distribution to the Trust beneficiary is correct.</p> <p>25 Is that a fair statement?</p>
Page 1809	Page 1811
<p>1 things like that, to make sure that the payment went out</p> <p>2 correctly.</p> <p>3 Q. Did you determine that the information on the IRMS system</p> <p>4 was posted accurately?</p> <p>5 A. We did not determine if the information on the IRMS system</p> <p>6 was posted accurately.</p> <p>7 Q. Did you explore whether or not the information was</p> <p>8 inaccurate?</p> <p>9 A. Yes.</p> <p>10 Q. Did you find inaccuracies?</p> <p>11 A. Yes.</p> <p>12 Q. Was it a common problem?</p> <p>13 MR. KIRSCHMAN: Objection. Leading, vague.</p> <p>14 THE COURT: Sustained.</p> <p>15 BY MR. GINGOLD:</p> <p>16 Q. How frequently did you experience that problem?</p> <p>17 A. It occurred on occasion where we found there might have been</p> <p>18 a probate order that went out and it failed to include an</p> <p>19 adoption decree. Or we found in one case there was a</p> <p>20 misallocation, and the Office of Trust Funds Management</p> <p>21 contacted my office, talked to me specifically, and asked that</p> <p>22 we get verification from landowners as to their ownership in</p> <p>23 that particular allotment. They didn't have any records, hard</p> <p>24 copy documents, supporting the ownership.</p> <p>25 Q. Was that only one example of a problem that you can recall?</p>	<p>1 A. Yes.</p> <p>2 Q. And if you didn't look at all those documents, would you be</p> <p>3 able to conclude that the posting and distribution was correct?</p> <p>4 A. You would not.</p> <p>5 Q. Isn't it reasonable to be able to take a shorter process to</p> <p>6 come to the conclusion, as opposed to going through the entire,</p> <p>7 what you characterize as a complex process?</p> <p>8 THE COURT: Sustained, the objection that Mr. Kirschman</p> <p>9 made by standing up behind you.</p> <p>10 BY MR. GINGOLD:</p> <p>11 Q. You did not take a short process to determine whether or not</p> <p>12 the posting information was accurate, did you?</p> <p>13 A. You know, our responsibility, we had a fiduciary</p> <p>14 responsibility. And when you look at that responsibility, it</p> <p>15 does not mean looking at just ownership, it means looking at</p> <p>16 every part of the distribution of income to landowners from the</p> <p>17 lease to the ownership; every aspect.</p> <p>18 Q. And if one part of it is wrong, could the result be wrong as</p> <p>19 a result of that process?</p> <p>20 MR. KIRSCHMAN: Objection. Leading, lack of</p> <p>21 foundation.</p> <p>22 THE COURT: Sustained.</p> <p>23 BY MR. GINGOLD:</p> <p>24 Q. What happens if any part of that process is wrong?</p> <p>25 A. The payment going to the individual may or may not get to</p>

Page 1812	Page 1814
<p>1 them. It may be incorrect, they may get too much, they may get 2 too little. 3 Q. So if you only reviewed the electronic posted information 4 and compared it to hard copy documents that you could find, 5 would that be adequate for you if you were determining the 6 accuracy of the IRMS posting? 7 MR. KIRSCHMAN: Objection, vague. 8 THE COURT: I'm going to sustain the objection, not 9 because it's vague but because I'm not sure this witness -- 10 whether it's adequate for this witness' material. 11 BY MR. GINGOLD: 12 Q. You did audits. Correct? 13 A. Yes. 14 Q. And when you were doing audits, what were you intending to 15 do with those audits? 16 A. We intended to get the correct money to the landowners. 17 Q. And when you were doing that, you went through a series of 18 procedures. Correct? 19 A. Yes, that is correct. 20 Q. And the procedures you describe are procedures that you 21 believed were important to be able to identify the correct 22 amount posted and distributed. Correct? 23 A. Yes. Let me give you an example. In 2002, the Inspector 24 General came in and did an audit of our audits. They wanted to 25 look at our audits and find out, how did we get the money to the</p>	<p>1 Q. How do you know yours was the only office that had the 2 complete authority across the three bureaus? 3 A. Because we were delegated that authority. 4 Q. Were you told yours was the only office, or did you know it? 5 A. We knew it was the only office. 6 MR. GINGOLD: No further questions, Your Honor. 7 THE COURT: You said there was a pilot project that was 8 going to spread across Indian country. Was it? What happened 9 to it? 10 THE WITNESS: The office became a permanent office in 11 2001, and departmentalized. The Office of Management and Budget 12 wanted to continue to spread it elsewhere. We did an analysis, 13 and -- in 2002. And after 2003, I left, and I don't think it's 14 been pushed to any other locations at this point, Your Honor. 15 THE COURT: You said that you blew the whistle. 16 Whistle-blowing is a sort of term of art. What did you mean 17 when you said you blew the whistle? 18 THE WITNESS: I filed a report with the Office of 19 Special Counsel, I filed a report with the Inspector General 20 describing some egregious and what I felt were breach of trust 21 type acts by the Department of Interior. 22 THE COURT: And what disposition, if any, was there of 23 what you filed? 24 THE WITNESS: The only awareness I have of anything 25 that was put in place permanently was the filings that are at</p>
Page 1813	Page 1815
<p>1 individual Indians. 2 They reviewed one of our audits that we did with my 3 office, and they asked us, "Now, how do you know the money went 4 out to the individuals?" And we said, "Because we looked at the 5 allocations from the lease, the settlement, to the monies that 6 went out to each individual on a per-individual basis, using IIM 7 databases. And then we contacted the individuals and asked them 8 if they got the money." 9 So yes, when we do an audit and we find monies that are 10 underpaid, we go through the entire system, the entire payment 11 process, all the way to the end, and the individual payment. 12 Q. And when you found an underpayment, did you correct it? 13 A. Yes, we did. 14 Q. And if you found a non-payment, did you correct it? 15 A. Yes. 16 Q. Do you know whether or not that was done before the FIMO 17 office was established? 18 A. I do not. 19 Q. Do you know whether or not that was done by MMS with regard 20 to its activities outside of FIMO? 21 A. From our -- 22 Q. From your direct knowledge, factual knowledge. 23 A. From my direct knowledge, and knowing in our office being 24 the only office that had complete cross authority through the 25 three bureaus, we were the only office doing that.</p>	<p>1 the Office of Special Counsel; and at the Inspector General 2 there are some documents. 3 THE COURT: And why did you leave in 2003? 4 THE WITNESS: I felt that I had -- that everything I 5 wanted to do and accomplish before that time period -- I was 6 able to capture a lot of back royalties for Indian landowners. 7 With the change of management, and with the changes in the 8 priority of the Department of Interior, I just felt like I could 9 not do my job, and I decided to resign my position. 10 THE COURT: And that's when you went into the private 11 sector? 12 THE WITNESS: Yes, Your Honor. 13 THE COURT: Thank you. Mr. Kirschman? 14 MR. KIRSCHMAN: The government has no questions for 15 this witness, Your Honor. 16 THE COURT: All right. Then sir, you are excused. 17 Mr. Gambrell, you may step down. Thank you. 18 THE WITNESS: Thank you, Your Honor. 19 THE COURT: Mr. Dorris? 20 MR. DORRIS: Your Honor, the plaintiffs call 21 Don Pallais. 22 (Oath administered by Courtroom Deputy.) 23 THE COURT: Spell your name please, sir. 24 THE WITNESS: Don, D-O-N; Pallais, P-A-L-L-A-I-S. 25 THE COURT: All right, thank you.</p>

14 (Pages 1812 to 1815)

Page 1816	Page 1818
<p>1 Proceed, Mr. Dorris.</p> <p>2 MR. DORRIS: Your Honor, we're calling Mr. Pallais</p> <p>3 today as an expert witness, and we'll be reviewing what he has</p> <p>4 done in his opinions in this matter. He is a CPA. And I will</p> <p>5 not go any further as to what those opinions are, since we'll</p> <p>6 let the witness tell you those.</p> <p>7 THE COURT: All right.</p> <p>8 (DON PALLAIS, PLAINTIFF witness, having been duly sworn,</p> <p>9 testified as follows:)</p> <p>10 DIRECT EXAMINATION</p> <p>11 BY MR. DORRIS:</p> <p>12 Q. Mr. Pallais has submitted an expert report which is</p> <p>13 Plaintiffs' Exhibit 4283, and if we could turn to page 28 of</p> <p>14 this expert report. The next page, please.</p> <p>15 Mr. Pallais, is this your resume' or CV from your</p> <p>16 expert report, that describes your background and experience?</p> <p>17 A. Yes, sir.</p> <p>18 Q. And in the first paragraph it indicates your years of</p> <p>19 experience, and very briefly what your work has been. Correct?</p> <p>20 A. Correct.</p> <p>21 Q. And then it goes on with further detail in terms of what</p> <p>22 you've done?</p> <p>23 A. Yes, sir.</p> <p>24 MR. DORRIS: Your Honor, we would tender Mr. Pallais as</p> <p>25 an expert on accounting and accounting procedures and methods.</p>	<p>1 records, and I've looked at other materials related to the case</p> <p>2 in general. I've also obviously referred to professional</p> <p>3 standards as necessary.</p> <p>4 Q. And you've listed the documents, at the time you prepared</p> <p>5 this report, as one of the attachments to your report that you</p> <p>6 had reviewed in conjunction with this work?</p> <p>7 A. That's correct.</p> <p>8 Q. And since that time, have you reviewed additional reports?</p> <p>9 A. I have looked at several hundred additional reports. I was</p> <p>10 provided with a CD that contained what I expect was the database</p> <p>11 that NORC used, and I reviewed probably close to 300 reports</p> <p>12 that were on that database.</p> <p>13 Q. And has that been referred to as the meta-analysis database?</p> <p>14 A. Yes, I believe this is the audit section of the</p> <p>15 meta-analysis database, is what I believe was contained on that</p> <p>16 CD. And I've reviewed all of the reports on that, which is</p> <p>17 roughly 300.</p> <p>18 I've also listened to testimony since preparing my</p> <p>19 report, and read portions of transcripts of testimony that I</p> <p>20 wasn't present for.</p> <p>21 Q. Okay. Mr. Pallais, have you formed -- or have you reviewed</p> <p>22 the 2007 plan?</p> <p>23 A. Yes.</p> <p>24 Q. And have you formed any opinions with regard to whether or</p> <p>25 not the 2007 plan can accomplish its stated goals?</p>
Page 1817	Page 1819
<p>1 THE COURT: All right. Without objection, he may</p> <p>2 testify in that field.</p> <p>3 BY MR. DORRIS:</p> <p>4 Q. Mr. Pallais, would you describe what you have done, the</p> <p>5 scope of your inquiry and what you have done prior to testifying</p> <p>6 here today?</p> <p>7 A. Before testifying today, I have reviewed a number of</p> <p>8 documents. They're listed in my report. But in essence they</p> <p>9 are a lot of auditors' reports, both independent auditors and</p> <p>10 government auditors. I've looked at the Accounting Standards</p> <p>11 Manual, the historic accounting plan, I've read some of the</p> <p>12 court opinions in cases.</p> <p>13 Q. Mr. Pallais, you've taken a document up to the stand with</p> <p>14 you. Would you tell us what that is?</p> <p>15 A. This is the front -- this is a reduced copy of the front</p> <p>16 part of my report.</p> <p>17 Q. Okay. And do you have any notes or anything --</p> <p>18 A. No, sir.</p> <p>19 Q. -- on that? And you will make that available to government</p> <p>20 counsel to look at if they want?</p> <p>21 A. Absolutely.</p> <p>22 Q. I'm sorry, I interrupted you. Go ahead.</p> <p>23 A. But I've looked at a number of things that discuss the</p> <p>24 approach that the government plans on taking; I've looked at</p> <p>25 documents that talk about the accuracy and reliability of</p>	<p>1 A. Yes, I have.</p> <p>2 Q. And what is your opinion?</p> <p>3 A. My opinion is that, based on the historical record, it is</p> <p>4 unlikely that it can achieve its goals because there will be</p> <p>5 insufficient reliability for the records reported to the</p> <p>6 individual account holders.</p> <p>7 Q. Okay. And let's look at your report. It will be page</p> <p>8 number two of the report, page three of the exhibit, which is</p> <p>9 Plaintiffs' Exhibit 4283.</p> <p>10 MR. DORRIS: The next page, please, sir. And would you</p> <p>11 blow up the middle there?</p> <p>12 BY MR. DORRIS:</p> <p>13 Q. And is this where you have written what your opinion is, and</p> <p>14 then four bullet points underneath that in further detail?</p> <p>15 A. Yes, sir.</p> <p>16 Q. Now, you indicate in the top there, "In my opinion, the 2007</p> <p>17 plan cannot accomplish its stated objective if the Trust's</p> <p>18 internal records are unreliable or incomplete."</p> <p>19 Have you personally gone and examined the department's</p> <p>20 records yourself, or done a personal audit of them?</p> <p>21 A. No, sir.</p> <p>22 Q. Have you reviewed reports by other CPAs or other people that</p> <p>23 have reviewed those documents?</p> <p>24 A. Yes, that is what I have done.</p> <p>25 Q. And have you reached any conclusion, based on those</p>

15 (Pages 1816 to 1819)

Page 1820	Page 1822
<p>1 documents that you've reviewed, in terms of the reliability and 2 completeness of the Trust internal records? 3 A. Based on the reports I've read, which is several hundred, 4 both government auditors and independent auditors, the message 5 over a long period of time is that there are substantial 6 problems in reliability of recordkeeping, internal controls are 7 weak, and as a result, it is apparent that the records are 8 unreliable without reference to external corroborating 9 information. 10 Q. Okay. What do you mean by external corroborating 11 information? 12 A. Well, what I'm saying is that you can't just rely on the 13 internal records. The internal control over these records is 14 obviously very weak, so the records on their own are apparently 15 unreliable. 16 Q. Now, Mr. Pallais, have you reached any -- have you reviewed 17 the Accounting Standards Manual that's part of the 18 administrative record? 19 A. Yes, I have. 20 Q. And it's referenced in the 2007 plan? 21 A. Yes. 22 Q. And have you reached any opinions as to whether or not the 23 procedures set forth in the Accounting Standards Manual meet 24 generally accepted accounting practices and procedures for 25 determining reliability?</p>	<p>1 compelling than what is described. 2 Q. When you talk about evidence they're going to get, evidence 3 they're going to get to do what? 4 A. Well, the point of the evidence gathering procedure is to 5 support the amounts that have been recorded in the Indian 6 accounts. So the question is: Are the amounts right, are they 7 reliable? And the evidence gathering effort is to provide a 8 basis to say that they are correct, reliable, accurate, 9 complete. 10 And that's what, presumably, they're getting evidence 11 to do. 12 Q. And when you say that you have questions about them because 13 they are -- you described what other evidence was specifically 14 permitted by the ASM. What do you mean? 15 A. Well, the ASM specifies the evidence it will consider to be 16 sufficient for the purposes of the reconciliation. The 17 auditor -- the independent accountant is not doing an audit and 18 choosing the evidence to achieve audit goals. The ASM specifies 19 what evidence the accountant should get, and it lists, for 20 different types of accounts, what evidence would be appropriate 21 and sufficient for this purpose. 22 So if the accountant gets that, the ASM considers that 23 he's done an adequate job in reconciling. There are a number of 24 types of evidence that are specifically listed, but when those 25 pieces of documentation are not available, the accountant is</p>
Page 1821	Page 1823
<p>1 A. Yes, I have. If this were to be an audit and relied on the 2 auditing standard, the procedures that are called for in the ASM 3 wouldn't meet the audit -- the evidence rules in an audit. 4 They're just too weak. 5 Q. You've talked about evidence rules in an audit. We talk 6 about evidence in court. Are you talking about the same thing? 7 A. No. We also use the word "evidence" when we're talking 8 about the amount of support you get in a financial statement 9 audit. In general, it's kind of the same thing, but we have 10 different rules for what level of evidence you need. And 11 they're probably not as precise as the rules that apply in a 12 courtroom. 13 Q. The third bullet here in what we're looking at talks about 14 the alternative procedures described in the Accounting Standards 15 Manual or the ASM. Would you explain what you're saying there? 16 A. Well, the ASM doesn't describe specifically what evidence is 17 required in the alternative procedures, so it's impossible to 18 tell what evidence they'll get from doing alternative 19 procedures. 20 But we know, or we infer from what the ASM says, that 21 these procedures are going to be -- this evidence is going to be 22 even less compelling than the evidence specifically called for 23 in the ASM. 24 So it's impossible to tell what evidence they will get, 25 but it's possible to infer that it's unlikely to be more</p>	<p>1 charged to go out and do an alternative procedure to try to get 2 something else. But the "something else" is never specified. 3 Q. Okay. You talk in the last bullet here, as you're setting 4 out your opinions, about reporting on recorded amounts without 5 regard to whether there are other items that should have been 6 included is insufficient. 7 Why do you say that's insufficient? 8 A. Well, when you're looking at this from an auditing 9 standpoint, we don't only report on what is recorded, but we 10 also have to consider what should have been recorded but wasn't. 11 So we not only report on what has been recorded, but we have to 12 consider whether something has been left out. 13 And it's only after we've considered whether it is 14 complete that we can determine that it's accurate. 15 Q. Okay. So this has to do with completeness? 16 A. Correct. 17 Q. Let's talk about the nature of the reporting that is going 18 to be done in the 2007 plan. And what is your understanding of 19 what is the goal for the so-called Historical Accounting Plan? 20 A. The goal as I understand it is to provide information for 21 the individual account holders, to let them know whether the 22 accounts are accurate. So they will be given the opening 23 balance in their account as of when the account was opened, or 24 1938 I think, if it goes back that far. 25 They'll be told what the activity has been in their</p>

16 (Pages 1820 to 1823)

Page 1824	Page 1826
<p>1 account, receipts and disbursements; they'll be told what the 2 account balance is at December 31st, 2000. They'll also be told 3 some additional information regarding accuracy of the accounting 4 done. I haven't seen exactly what that language is, but 5 supposedly they'll be told how to determine whether the account 6 is accurate.</p> <p>7 And they'll also be told what the account balance as of 8 December 31st, 2000 was previously reported to them.</p> <p>9 Q. Okay. And the process, part of the process in the 2007 plan 10 refers to a reconciliation for certain transactions as being 11 done. Is a reconciliation an accounting service that is 12 customarily done by CPAs?</p> <p>13 A. A reconciliation is not a standard service. We have a 14 number of standard services that we provide as a profession, and 15 we've got detailed standards underlying those. We've got 16 audits, for example, which is the highest level of service we 17 provide, where we go in and we test financial statements to 18 reduce the risk of missing a material misstatement to a low 19 level, and we issue an opinion that provides a high level of 20 assurance. We say the financial statements fairly present in 21 all material respects the financial positions of operations in 22 conformity with GAAP.</p> <p>23 We've got other services that we provide on financial 24 statements that are also detailed. For example, we have 25 reviews, which is slightly lower than an audit, and results in</p>	<p>1 the user of the financial statements, the decision maker, 2 doesn't want one of our standard services, but wants some 3 specific procedures applied. And in that case we allow, within 4 relatively wide range, the user to specify the procedures.</p> <p>5 So the user determines the scope. We don't determine 6 the scope, and we don't determine materiality, we just apply the 7 procedures specified, and report the results.</p> <p>8 Q. And where does this reconciliation fall within the services 9 that you've described?</p> <p>10 A. It doesn't. This is considered a consulting service.</p> <p>11 Q. Okay. And so that is a separate, then, service. And why do 12 you say that this is a consulting service, as opposed to one of 13 the standard services that accountants supply?</p> <p>14 A. Well, it's a consulting service because it meets the 15 definition of consulting services, and apparently it is what the 16 government and the accountants agreed it would be.</p> <p>17 Consulting services typically are done to achieve some 18 goal of the entity for whom it 's being provided. It's not 19 standard, we generally do not express assurance on the subject 20 matter that we're applying procedures on. So it can be a very, 21 very wide range of procedures.</p> <p>22 Essentially, the entity has some goal; they hire the 23 accountant to apply some procedures to achieve their goal, but 24 the accountant doesn't end up providing any assurance on the 25 subject matter itself.</p>
Page 1825	Page 1827
<p>1 negative assurance. We've got compilations, which are lower yet 2 than reviews, and end up providing no explicit assurance.</p> <p>3 We've also got a service that we do called agreed-upon 4 procedures, in which we go in and just apply whatever procedures 5 we're directed to, but don't express any explicit assurance.</p> <p>6 This service is a --</p> <p>7 Q. Let me interrupt you one second.</p> <p>8 A. Sure.</p> <p>9 Q. You've just listed at least three standard services that are 10 performed. I think you said audit, review, and compilation?</p> <p>11 A. Correct.</p> <p>12 Q. And then are there standards for the accounting profession 13 that each of those standard services are to meet?</p> <p>14 A. Yes. We have detailed standards that underlie each of them. 15 Audits are governed by generally accepted auditing standards, 16 which are expressed in terms of statements on auditing 17 standards. Compilations and reviews are governed by another set 18 of standards called "Statements on Standards For Accounting 19 Review Services." And agreed-upon procedures are covered by our 20 attestation standards.</p> <p>21 Q. Okay. Then you were talking about agreed-upon procedures as 22 another category of services?</p> <p>23 A. Correct.</p> <p>24 Q. And would you explain that?</p> <p>25 A. Well, agreed-upon procedures is a service we provide when</p>	<p>1 Q. Well, as part of the 2007 plan and reconciliation there, 2 what assurances can the accountants in that reconciliation 3 process, if any, provide?</p> <p>4 A. Well, as called for in the plan, the accountant doesn't 5 provide any assurance whatsoever on the Historical Statement of 6 Account. The accountant issues a report that essentially says, 7 "I have reconciled the account using the Accounting Standards 8 Manual." So essentially, what the accountant says is, "I've 9 done the job you hired me to do."</p> <p>10 Q. Okay. And is the Accounting Standards Manual, does it tell 11 the accountant to use its professional judgment to determine 12 what evidence was sufficient to reconcile the transaction?</p> <p>13 A. To an extent, it does. The Accounting Standards Manual 14 specifies the evidence it considers to be appropriate, and then 15 tells the accountant to consider -- although not follow, tells 16 him to consider Statement on Auditing Standards Number 31, which 17 is the evidence standard in generally accepted auditing 18 standards.</p> <p>19 So it sort of suggests that these procedures look like 20 audit procedures, but doesn't actually require that they be 21 audit procedures.</p> <p>22 Q. Now, as a result of the procedures that are set out in the 23 2007 plan, are they sufficient to provide the accountant with a 24 basis to provide reasonable assurance on the information that is 25 being set out in the Historical Statement of Account?</p>

Page 1828	Page 1830
<p>1 A. No. The procedures that are called for don't actually meet 2 the standards that we would require as a profession to provide 3 that sort of assurance. 4 Q. Why do you say that? 5 A. The procedures don't meet the SAS-31 guidelines. They are 6 insufficient in general. They tend to rely on internal 7 documents without having tested the effectiveness of internal 8 control and reliability of those documents. 9 Q. You've referred to evidence, or what I'll call accounting 10 evidence that an accountant looks for or uses when it's 11 performing some service. And I want to ask you some questions 12 about the competence of accounting evidence. 13 Does the type of documentation specified in the 14 Accounting Standards Manual to be used in reconciling 15 transactions represent in your opinion competent evidential 16 matter under generally accepted accounting standards? 17 A. Generally accepted auditing standards? 18 Q. Excuse me, auditing standards. Thank you. 19 A. No. 20 Q. And why do you say that? 21 A. As I've mentioned, the things that they call on to be tested 22 are not broad enough, and the evidence that they rely on is not 23 persuasive enough. 24 Q. What do you mean, not broad enough and not persuasive 25 enough?</p>	<p>1 are you talking about now? 2 A. What we're saying is, the financial statements are making -- 3 when these amounts are included in the financial statements, 4 management is making assertions about these five items. And the 5 assertions they're making are that, in existence, everything 6 that has been recorded has either -- either exists or has 7 occurred. 8 For completeness, they are saying that everything that 9 exists or has occurred has actually been captured by the 10 accounting system and is included in the financial statements. 11 So they're sort of complements to each other. 12 For valuation, they're saying the amount has been 13 calculated in accordance with the criteria in use. So in 14 financial reporting, typically that's generally accepted 15 accounting principles. 16 For rights and obligations, they're saying that if we 17 say we own it, if we say it's an asset, we actually own it. If 18 they say it's a liability, we actually owe it. 19 And presentation and disclosure means that it has been 20 presented and disclosed in accordance with whatever criteria 21 apply. So increases are shown as increases, and decreases are 22 shown as decreases. 23 And we have to get -- in an audit we have to get 24 persuasive evidence for each of the relevant assertions for 25 every account balance and class of transactions.</p>
Page 1829	Page 1831
<p>1 A. Well, under SAS-31 -- 2 Q. Okay. SAS-31 is the Statement of Auditing Standards? 3 A. Right. SAS stands for "Statement on Auditing Standards." 4 That's how we express the generally accepted auditing standards 5 in use in the United States. 6 Q. Okay. Go ahead. 7 A. Under SAS-31, when we audit an account or a class of 8 transactions, we don't just look at the total amount. What we 9 look at is the assertions underlying the account. And under 10 SAS-31, we believe, or our concept is, that management makes 11 five assertions for every significant account balance or class 12 of transactions. 13 The five assertions are: Existence or occurrence; 14 completeness; valuation; rights and obligations; and 15 presentation and disclosure. So for each account balance or 16 class of transactions, we have to satisfy ourselves that, in 17 existence, we are saying that everything -- 18 Q. Can you stop one second? 19 A. Sure. 20 Q. Can you go back over the list of five for me? I had 21 "existence," and then what were the other four? 22 A. Second one was completeness, the third was valuation, the 23 fourth was rights or obligations, and the fifth is presentation 24 and disclosure. 25 Q. And when you say that these are assertions, help me. What</p>	<p>1 MR. DORRIS: Your Honor, the look I've just gotten from 2 the court reporter reminds me that it may be time for a morning 3 break. 4 THE COURT: You got that look because there's a 5 computer screen between me and the court reporter. We'll be in 6 recess for 10 minutes. 7 (Recess taken at 11:25 a.m.) 8 BY MR. DORRIS: 9 Q. Mr. Pallais, you had just described the five items under 10 SAS-31 that the accountant would need to have persuasive 11 evidence on each of those five. And I want to concentrate on 12 the first one dealing with existence and the second one dealing 13 with completeness. Okay? 14 A. Yes, sir. 15 Q. Now let's turn to existence. Can an auditor rely on 16 internal accounting documents in doing an audit, or must they 17 only consider third-party documents? 18 A. The auditor can choose what evidence to rely on. 19 Third-party documents are generally the best. We can use 20 internal documents if we have satisfied ourselves that the 21 internal control used to generate them are effective, and 22 therefore, the internal documents are reliable. 23 We can do this only if we have identified effective 24 controls and tested them to determine that they're working 25 effectively.</p>

18 (Pages 1828 to 1831)

Page 1832	Page 1834
<p>1 Q. Okay. When you talk about internal control, what are you 2 talking about, from an accounting standpoint?</p> <p>3 A. Well, internal control refers to the systems and processes a 4 company institutes or an entity institutes to assure that its 5 financial reporting is accurate. Our definition and our model 6 for internal control nowadays comes out of what we call the COSO 7 report.</p> <p>8 Q. That's C-O-S-O?</p> <p>9 A. Yes. It stands for the Council of Sponsoring Organizations 10 of the Treadway Commission. The report is formally titled 11 "Internal Control Integrated Framework." And this is the 12 criterion we use. When we look at internal control in an audit, 13 it's also the criterion that is almost universally used when 14 companies report on the effectiveness of their internal control 15 under Sarbanes-Oxley Act.</p> <p>16 Q. And this, what you refer to as COSO, standards for internal 17 control, can you describe those to us?</p> <p>18 A. Yes. What COSO says is that the system is designed to 19 provide assurance of accurate financial reporting, and when we 20 look at internal control, we look at it in terms of the five 21 components. There are five components under the COSO report.</p> <p>22 Q. Okay. Can you list those five components? The last time we 23 had five components. Is it always five?</p> <p>24 A. We try to do that, yes, because that's how many fingers we 25 have.</p>	<p>1 financial reporting; do they communicate to the employees that 2 this is important, that systems are designed appropriately for 3 good financial reporting; do they send the message that they 4 expect things to be right, or do they live with things that are 5 wrong.</p> <p>6 When they see weaknesses in controls, do they work to 7 rectify them or are they living with them? Are they willing to 8 overlook controls, override controls, and do they take action 9 when they see controls aren't being applied as they should.</p> <p>10 So it's sort of what underlies all of internal control.</p> <p>11 Q. The second one you mentioned, and I think you called it 12 something else but then said it's really talking about the 13 accounting system itself. What do you mean in terms of talking 14 about internal controls and looking at this second element?</p> <p>15 A. The second element, the accounting system, is how 16 transactions are actually processed. It talks about the actual 17 processes and the records used to initiate and capture a 18 transaction, summarize it, and report it in the financial 19 statement.</p> <p>20 So it's how the transaction gets initiated, captured, 21 summarized, and reported. And what you're looking for there is 22 that at the end of the process, the amount of statements 23 reported in the statement, or in this case the statement of 24 account, actually reflects the transaction that was entered 25 into.</p>
Page 1833	Page 1835
<p>1 THE COURT: Not bad.</p> <p>2 MR. DORRIS: I'm not going to touch that one, Judge.</p> <p>3 BY MR. DORRIS:</p> <p>4 Q. Would you tell us, are all five factors relevant here?</p> <p>5 A. For our purposes, really only three of the five are 6 relevant.</p> <p>7 Q. Would you tell us those three first?</p> <p>8 A. Yes. The three that are particularly relevant are called 9 the control environment; something called information and 10 communication, but for our purposes, we can just call it the 11 accounting system; and control activities.</p> <p>12 Q. Okay. And what are the other two and why are you saying 13 they're not relevant?</p> <p>14 A. The other two are called risk assessment and monitoring, and 15 these are really only relevant to better systems. We only look 16 at those when we're looking to see how a good system maintains 17 its quality.</p> <p>18 So in an area where we have weak systems, those two 19 components really don't add very much.</p> <p>20 Q. Okay. Let's go through the three you mentioned; control 21 environment, accounting system, and control activities. What is 22 being referred to when you talk about control environment?</p> <p>23 A. The control environment is management's attitude, actions, 24 and awareness about controls and their importance in the entity. 25 And what this refers to is, is management committed to good</p>	<p>1 And what you're looking for here is to make sure that 2 things are accurately captured, they're accurately summarized, 3 they're accurately processed, so at the end, you end up with an 4 accurate rendition of what actually took place in the business, 5 or in this case, the account.</p> <p>6 Q. Okay. And then the third item that you mentioned in 7 connection with determining the effectiveness of internal 8 controls was, I think you referred to it as control activities. 9 What do you mean?</p> <p>10 A. The control activities are sort of the disciplines over the 11 accounting system. These are the checks and balances a company 12 creates to make sure the accounting system is accurate.</p> <p>13 So it refers to things like segregation of duties, 14 where one person checks the work of another person; it requires 15 approvals to make sure that only transactions that are 16 authorized are entered into; it deals with things that check the 17 accuracy after the fact, like reconciliations, to make sure that 18 the amount that was reported actually agrees to some other 19 record that should serve as a check on it.</p> <p>20 So when we look at internal control, generally we look 21 at all three of these elements to make sure that control is 22 effective.</p> <p>23 Obviously, if the accounting system is weak and does 24 not accurately capture or summarize transactions, there are 25 going to be mistakes, or there could be mistakes, and the</p>

Page 1836	Page 1838
<p>1 resulting financial information may very well be inaccurate.</p> <p>2 If the controls are not working, the control activities</p> <p>3 are not working, then management doesn't have any assurance that</p> <p>4 the accounting system is working. And if the control</p> <p>5 environment is weak, and management is sending the message that</p> <p>6 we really don't care if the controls work or not, then it really</p> <p>7 doesn't matter if the accounting system and control activities</p> <p>8 work, because good controls are unlikely to be effective in the</p> <p>9 presence of a poor control environment.</p> <p>10 Q. And does the Accounting Standards Manual and what is being</p> <p>11 set out in the 2007 plan, does it indicate to that there be a</p> <p>12 test for internal control?</p> <p>13 A. No.</p> <p>14 Q. Now, in terms of an auditor doing an audit, which is one of</p> <p>15 the services you indicated is a common service that has</p> <p>16 standards underlying it, what happens if the auditor finds that</p> <p>17 there are weaknesses with respect to internal controls? What</p> <p>18 does the auditor do?</p> <p>19 A. The auditor is not required to look for weaknesses, the</p> <p>20 auditor only has to understand controls sufficient to plan the</p> <p>21 audit. So we're not required the look for weaknesses, we're not</p> <p>22 required to test to see if controls are actually effective in a</p> <p>23 GAAS audit.</p> <p>24 Where we do find weaknesses, we can generally continue</p> <p>25 the audit and merely not rely on that control; in other words,</p>	<p>1 that we've referred to here in this court?</p> <p>2 A. I've reviewed the audit reports, yes.</p> <p>3 Q. Now, let's look at one to use as an example.</p> <p>4 MR. DORRIS: And if we could pull up, let's look at</p> <p>5 front page, which is in the administrative record as 66-5-2,</p> <p>6 which is one of the reports. But we will be looking at</p> <p>7 different sections than we have before, is the audit report, it</p> <p>8 turns out it's from Griffin, with this cover page indicating</p> <p>9 December 1996.</p> <p>10 BY MR. DORRIS:</p> <p>11 Q. Do you see that?</p> <p>12 A. Yes, sir.</p> <p>13 Q. And then let's look over at this administrative record, page</p> <p>14 number nine of Bates document 66-5.</p> <p>15 MR. DORRIS: And if you'd blow that up in the middle?</p> <p>16 BY MR. DORRIS:</p> <p>17 Q. This is then the section of the report where it begins</p> <p>18 describing the audit itself as opposed to the cover memo that</p> <p>19 accompanied it. Do you see that?</p> <p>20 A. Yes, sir.</p> <p>21 Q. And let's look then at Bates page 15, so 66-5-15.</p> <p>22 MR. DORRIS: And if you will blow up the top there so</p> <p>23 we can see it more clearly.</p> <p>24 BY MR. DORRIS:</p> <p>25 Q. And this is the report of independent public accountants on</p>
Page 1837	Page 1839
<p>1 we will not be relying on the entity to prevent or detect its</p> <p>2 own misstatements. When we're looking for misstatements, we</p> <p>3 have to design tests specifically to look for misstatements. We</p> <p>4 call these substantive tests. And we can continue an audit even</p> <p>5 in the face of weaknesses in internal control.</p> <p>6 Q. Okay. Even though they don't go in to test internal</p> <p>7 controls, if a weakness is found, they can still continue with</p> <p>8 the audit. Is that right?</p> <p>9 A. Yes. And that's very common. I would venture to say that</p> <p>10 in the majority, probably the vast majority of GAAS audits, we</p> <p>11 encounter weaknesses in internal control, but we still complete</p> <p>12 the audit.</p> <p>13 Q. Are tests then done once weaknesses are discovered to try to</p> <p>14 determine the extent or the pervasiveness of the problems with</p> <p>15 internal controls?</p> <p>16 A. We're not required to do that in a GAAS audit. What often</p> <p>17 happens is we merely understand controls enough to be able to</p> <p>18 identify the kinds of misstatements that can occur, where areas</p> <p>19 increase risk, the things that are more likely to be wrong, and</p> <p>20 to design our tests of the account balances and transactions.</p> <p>21 So typically, we can do that even in the face of weak</p> <p>22 controls.</p> <p>23 Q. Okay. Now, have you reviewed the audits of Arthur Andersen</p> <p>24 in the late 1980's and early 1990's, and then the audits of</p> <p>25 Griffin beginning, I think, in 1995, and then KPMG on up to 2006</p>	<p>1 the financial statement. It's on Griffin & Associates</p> <p>2 letterhead, and it confirms in the first paragraph that it is a</p> <p>3 review of the financial statements through September 30th, 1995.</p> <p>4 And it describes the various financial statements that it is a</p> <p>5 review of. Do you see that?</p> <p>6 A. Yes.</p> <p>7 Q. Now, you've indicated that even where problems with internal</p> <p>8 controls may appear, an auditor could continue with the audit.</p> <p>9 I want us to look at what the auditor says here as to what the</p> <p>10 effect those internal controls had in this particular instance.</p> <p>11 Okay?</p> <p>12 A. Okay.</p> <p>13 Q. Let's look at the second paragraph. And the first sentence</p> <p>14 there in the second paragraph indicates, "Except as discussed in</p> <p>15 the following paragraph, we conducted our audit in accordance</p> <p>16 with generally accepted auditing standards, standards for</p> <p>17 financial audits contained in government auditing standards,</p> <p>18 1994 revision issued by the comptroller general of the United</p> <p>19 States, and Office of Management and Budget bulletin 93-06."</p> <p>20 And then it gives the title for that particular</p> <p>21 bulletin. Do you see that?</p> <p>22 A. Yes, sir.</p> <p>23 Q. And so this is then indicating that it conducted the audit</p> <p>24 in accordance with these generally accepted auditing standards</p> <p>25 that it then sets out, except as indicated in the next</p>

Page 1840	Page 1842
<p>1 paragraph?</p> <p>2 A. Correct.</p> <p>3 Q. All right. Let's look at the next paragraph.</p> <p>4 Now, let me give you a moment to look at that</p> <p>5 paragraph.</p> <p>6 A. (Witness complies.)</p> <p>7 Q. What does this tell you as a CPA in reviewing this financial</p> <p>8 statement?</p> <p>9 A. What this says is Griffin & Associates found substantial</p> <p>10 problems that were so pervasive that they could not do the</p> <p>11 procedures required in a GAAS audit. They've mentioned several</p> <p>12 problems, one of which is the major inadequacies in the</p> <p>13 accounting system.</p> <p>14 Q. Is that number three in this paragraph?</p> <p>15 A. Yes.</p> <p>16 Q. It says, "Major inadequacies in the trust fund accounting</p> <p>17 systems, controls, and records caused them to be unreliable."</p> <p>18 Does that have anything to do with internal control?</p> <p>19 A. Right. What they're saying there is, controls were bad,</p> <p>20 there were deficiencies. Now, in a typical audit we find</p> <p>21 deficiencies. That's not at all unusual. And we still give an</p> <p>22 unqualified opinion, because the deficiencies do not prevent us</p> <p>23 from doing other types of procedures.</p> <p>24 Here, what Griffin is saying is, these deficiencies</p> <p>25 were so pervasive that they could not do a GAAS audit. They</p>	<p>1 administrative record at Bates page number 66-5-16.</p> <p>2 And at the top of the next page, would you take a</p> <p>3 moment and review that?</p> <p>4 A. (Witness complies.) Yes, sir.</p> <p>5 Q. Mr. Pallais, lawyers sometimes are criticized for not</p> <p>6 writing clearly. But can you explain what is being indicated</p> <p>7 here in this audit as you as a CPA would read it?</p> <p>8 A. Well, in a typical audit, the phrase that says, "except</p> <p>9 for," is not included. So a typical audit says, "In our</p> <p>10 opinion, the financial statements represent fairly the financial</p> <p>11 statements in all material respects in conformity with the</p> <p>12 criteria."</p> <p>13 Here what they're saying is, except for the matters we</p> <p>14 talked about in the previous paragraph, the financial statements</p> <p>15 are fairly presented in conformity with the criteria. What</p> <p>16 they're saying here is, that we don't know. We don't know if</p> <p>17 the financial statements are right or wrong. This is what is</p> <p>18 called a qualified opinion.</p> <p>19 MR. SIEMIETKOWSKI: Objection, Your Honor. The</p> <p>20 document speaks for itself.</p> <p>21 THE COURT: Elliptically. But I agree, it does speak</p> <p>22 for itself. Sustained.</p> <p>23 BY MR. DORRIS:</p> <p>24 Q. Now, the paragraph that's stated here, is this what would be</p> <p>25 referred to as a qualified opinion?</p>
Page 1841	Page 1843
<p>1 could not overcome these problems, which is a very unusual</p> <p>2 situation.</p> <p>3 Q. Why do you say that's unusual?</p> <p>4 A. Well, as I mentioned before, in the majority or vast</p> <p>5 majority of GAAS audits, we find deficiencies in internal</p> <p>6 controls, often material weaknesses in internal controls, yet we</p> <p>7 still are able to apply enough tests to reduce audit risk to an</p> <p>8 appropriately low level and to provide an unqualified opinion.</p> <p>9 Here they're unable to do that.</p> <p>10 Q. Is this paragraph, is this paragraph stating that the</p> <p>11 opinion in this report is qualified?</p> <p>12 A. No, that's the next paragraph.</p> <p>13 Q. Okay.</p> <p>14 A. This is the explanatory paragraph that says why the opinion</p> <p>15 is going to be qualified.</p> <p>16 Q. Okay. The last sentence of this paragraph says, "Because of</p> <p>17 these matters, it was not practicable to extend our auditing</p> <p>18 procedures to enable us to express an opinion regarding the</p> <p>19 basis on which cash and trust fund balances are stated."</p> <p>20 Do you see that?</p> <p>21 A. Yes, sir.</p> <p>22 Q. And when it talks about cash and trust fund balances, what's</p> <p>23 that talking about?</p> <p>24 A. That's talking about the financial statements.</p> <p>25 Q. Now let's look at the top of the next page. So we're in the</p>	<p>1 A. Yes, this is a qualified opinion.</p> <p>2 Q. Now, in all of the audits that you reviewed from Arthur</p> <p>3 Andersen, Griffin, and KPMG, were any of them unqualified?</p> <p>4 A. No.</p> <p>5 Q. And whether it was this exact same language or not, was</p> <p>6 there similar language in each of those audits, beginning</p> <p>7 sometime in the late 1980's all the way through 2006 for the</p> <p>8 years that they were performed?</p> <p>9 A. Yes, for each one that I read, each auditor was unable to</p> <p>10 complete the audit because of weaknesses in internal control.</p> <p>11 And in each case, they qualified their opinion for that reason.</p> <p>12 Q. Okay. Now, would an auditor normally attempt -- before they</p> <p>13 give a qualified opinion, attempt to do tests or other steps to</p> <p>14 overcome the concern with internal controls, and therefore not</p> <p>15 have to give a qualified opinion?</p> <p>16 A. Yes, typically, that's what happens, is our procedures are</p> <p>17 sufficient even in the case of weak internal control.</p> <p>18 In this case what they're saying is they couldn't</p> <p>19 design procedures to accomplish that, and as a result, could not</p> <p>20 give an unqualified opinion on the financial statements.</p> <p>21 Q. Now, what about -- you indicated that you reviewed a number</p> <p>22 of other reports in addition to these, many of which were on a</p> <p>23 CD dealing with the meta-analysis. What did you see in -- were</p> <p>24 those full audits such as the ones Arthur Andersen, Griffin, and</p> <p>25 KPMG did?</p>

21 (Pages 1840 to 1843)

Page 1844	Page 1846
<p>1 A. Typically, a lot of them were -- a lot of the documents were 2 incomplete. So all I know is what I read, and I don't know what 3 would have been on the pages that I didn't see. 4 But they typically were what we call operational audits 5 as opposed to financial statement audits. So they did not have 6 a report that looked like this and they did not typically have a 7 report that expressed any sort of explicit assurance. 8 Q. And of those other reports that you read, approximately how 9 many did you review? 10 A. I would say I reviewed somewhere in the neighborhood of 300. 11 Q. And would you tell the Court what you found in reviewing 12 those audits with respect to internal controls? 13 A. I would say with -- 14 MR. SIEMIETKOWSKI: Objection, Your Honor. Those 15 documents also speak for themselves and they're part of the 16 administrative record. 17 MR. DORRIS: Your Honor, these are not part of the 18 administrative record. These are documents that were produced 19 at the end of September or early October. 20 THE COURT: Would you repeat your question? I was 21 rebooting this computer for about the fourth time this morning. 22 MR. DORRIS: I don't know if I can repeat it exactly, 23 but I'll do the best I can, Your Honor. 24 BY MR. DORRIS: 25 Q. Would you please describe for the Court what you saw in</p>	<p>1 Q. I think you can go ahead. 2 THE COURT: It's like asking orthopedic surgeons and 3 neurological surgeons about back surgery. They both know 4 something about it. 5 A. So my goal was to see whether I agreed with their 6 characterization of the reports as either unqualified, 7 qualified, or the other categories they had. 8 And since they didn't provide a categorization of the 9 300 reports, I read them to see if I could characterize them, 10 and I don't believe it is possible to do that. 11 BY MR. DORRIS: 12 Q. Why do you say that? 13 A. Well, as I mentioned, most of the reports don't express any 14 assurance, so you have to infer what the auditor would have said 15 if he expressed assurance over a 50-year or longer period of 16 time. 17 Without looking at the work papers, this is hard -- in 18 this case, the reports don't even explain what the scope of 19 their audit was. All they report in most cases is findings. 20 So, for example, if there's a finding that says, we 21 found that something wasn't reconciled, you have no way of 22 knowing how significant that was. If they were only doing one 23 procedure, which was see if this is reconciled, then the fact 24 that it's not reconciled means it's an adverse report; we looked 25 at one thing, it wasn't done, they failed.</p>
Page 1845	Page 1847
<p>1 those reports with respect to what they indicated to you 2 regarding internal controls? 3 A. The reports, with only a handful of exceptions, all 4 criticized internal control and identified deficiencies in 5 internal control. 6 Q. Now, those were reports that were referenced in the 7 meta-analysis that NORC did. Did you review the meta-analysis 8 report of NORC? 9 A. Yes, I did. 10 Q. Based on your review of those reports, these additional 11 reports on which NORC issued its report, did you agree with what 12 NORC had to say about what those reports showed? 13 A. No. 14 Q. Would you explain, please? 15 A. Well, my first problem was that NORC did not provide a 16 method to reconcile their summary to the individual reports. 17 MR. SIEMIETKOWSKI: Objection, Your Honor. The witness 18 has not been qualified to testify regarding meta-analysis. He's 19 an accountant. 20 THE COURT: Meta-analysis has nothing to do with 21 accounting? Is that your position? 22 MR. SIEMIETKOWSKI: Our position, Your Honor, is that 23 it's statistics but not accounting. 24 THE COURT: Overruled. 25 BY MR. DORRIS:</p>	<p>1 If they were doing 100 procedures and this was the 2 least significant of them, then perhaps it's an unqualified 3 report. If it's someplace in the middle, we don't know what the 4 effect would be. 5 So reading these reports, it is impossible to figure 6 out what the effect of their findings would have been on the 7 assurance they would have provided. The only thing we can take 8 away from this is that in virtually every case, they found 9 internal control problems. 10 Q. Okay. Based on the documents you've reviewed and that 11 you've described here today, have you formed an opinion on the 12 effectiveness and the strength of the internal controls of the 13 accounting systems at the Department of Interior? 14 A. Yes. 15 Q. And what is that? 16 A. Based on the consistent criticism of internal control, 17 consistent characterization of it as unreliable, I would say 18 that their systems are unreliable and you can't use their 19 internal documents as audit evidence. 20 Q. The last words I did not catch. You could not use it as 21 hard evidence? 22 A. As audit evidence. 23 Q. Audit evidence. Okay. 24 Now, where there are these problems with internal 25 controls in a company or agency, what can you use to try to do</p>

Page 1848	Page 1850
<p>1 reconciliations?</p> <p>2 A. Well, if this were an audit, we would rely on corroborating</p> <p>3 information, generally third-party information; for example,</p> <p>4 invoices, checks, things that come from outside or have</p> <p>5 indications of independent verification.</p> <p>6 Q. Okay. Let's talk about, and let's bring it right to this</p> <p>7 matter dealing with land-based IIM accounts. When you talk</p> <p>8 about third-party documents that would need to be used as</p> <p>9 corroborating audit evidence as opposed to internally generated</p> <p>10 documents, what are you talking about?</p> <p>11 A. Things like leases, things like a check that has been</p> <p>12 endorsed by the user or by the payee, authorizations from</p> <p>13 outside the organization, things like that.</p> <p>14 Q. And so a check that's issued by an organization but endorsed</p> <p>15 by someone else that comes back as then -- you're talking about</p> <p>16 that could be a third-party document at that point?</p> <p>17 A. Yes.</p> <p>18 Q. Now, does the Accounting Standards Manual require in the</p> <p>19 reconciliation process that only third-party documents, such as</p> <p>20 the ones you just described, be used to reconcile transactions?</p> <p>21 A. No.</p> <p>22 Q. And is that a problem?</p> <p>23 A. Yes, it is.</p> <p>24 Q. Why?</p> <p>25 A. Well, what they're saying is that the procedures are going</p>	<p>1 reconcile?</p> <p>2 A. Correct.</p> <p>3 Q. Let's at least look at one example, Mr. Pallais. Let's look</p> <p>4 in the Accounting Standards Manual that is up on the screen, and</p> <p>5 that would be 44-1-1 in the administrative record. And let's go</p> <p>6 to Bates page 31.</p> <p>7 MR. DORRIS: Your Honor, I have not been in the court</p> <p>8 the entire time, but I'm not sure you've been shown the</p> <p>9 Accounting Standards Manual before.</p> <p>10 THE COURT: I've been shown pieces of it.</p> <p>11 MR. DORRIS: Okay.</p> <p>12 BY MR. DORRIS:</p> <p>13 Q. This is then -- indicates this is regarding disbursements,</p> <p>14 and this is the general table indicating the different levels</p> <p>15 and documents to be used.</p> <p>16 For example, would you just describe what we're talking</p> <p>17 about on the first line here where it has the first place, it</p> <p>18 says Level One?</p> <p>19 A. Well, what this is saying is for general disbursements, one</p> <p>20 of the Level One sources of evidence might be checks and</p> <p>21 electronic transfers where they have confirmed the negotiation.</p> <p>22 And on table one, they list the sources of documents that the</p> <p>23 accountant could rely on in satisfying himself about</p> <p>24 disbursements.</p> <p>25 Q. Okay. And you've indicated that a document that could be</p>
Page 1849	Page 1851
<p>1 to rely to a large extent on internal documents generated from a</p> <p>2 system that is by all reports unreliable.</p> <p>3 So the evidence they're going to be relying on is</p> <p>4 unreliable.</p> <p>5 Q. Where there are issues about the reliability of internal</p> <p>6 documents, can an auditor then do reconciliations based on those</p> <p>7 internal documents to overcome that concern about the</p> <p>8 reliability of the internal documents?</p> <p>9 A. No. Because you know they are unreliable.</p> <p>10 Q. Now, you've talked today also for a few minutes about the</p> <p>11 alternative procedures that would be permitted by the Accounting</p> <p>12 Standards Manual. And I think there's been earlier testimony;</p> <p>13 Mr. Duncan described those to the Court. But can you describe</p> <p>14 from a CPA's standpoint where those fit in the hierarchy of the</p> <p>15 Accounting Standards Manual as the evidence to be used?</p> <p>16 A. What the Accounting Standards Manual sets out is two</p> <p>17 explicit levels of assurance. They've got what they call Level</p> <p>18 One, which is their best evidence, for lack of a better word.</p> <p>19 If you can't get one of the documents in their Level One, the</p> <p>20 reconciling accountant is told to use one of the second best</p> <p>21 documents, which is what they call Level Two.</p> <p>22 If you can't get Level One or Level Two, the accountant</p> <p>23 is told to do an alternative procedure.</p> <p>24 Q. Okay. So it would be -- the alternative procedure is to be</p> <p>25 used if you can't get a Level One or a Level Two document to</p>	<p>1 relied on would be a canceled endorsed check. Correct?</p> <p>2 A. Correct.</p> <p>3 Q. Now, look down at the third line there. It says, "Level</p> <p>4 One, Table Three, schedules for disbursement." And then that's</p> <p>5 an indication that a schedule for disbursement and the documents</p> <p>6 set out in table three would also be considered to be a Level</p> <p>7 One reconciliation?</p> <p>8 A. According to the Accounting Standards Manual, yes.</p> <p>9 Q. Now, if one of these documents cannot be found, or the</p> <p>10 documents that are talked about here in this table, is it still</p> <p>11 possible under the 2007 plan for the person doing the</p> <p>12 reconciliation to consider the item to be reconciled?</p> <p>13 A. Well, if they can't find one of the Level One items, they</p> <p>14 would go to the Level Two schedule and they would try to satisfy</p> <p>15 themselves by looking at some of the documents listed in the</p> <p>16 Level Two schedule.</p> <p>17 Q. And the documents that are listed here are a number of these</p> <p>18 documents, third-party documents that you've talked about, or</p> <p>19 are they internal documents?</p> <p>20 A. Near as I can tell, most of them are internal documents.</p> <p>21 Q. Now, let me go back. You had talked about the different</p> <p>22 items that have to be considered under SAS-31, and we've talked</p> <p>23 about the first item existence. The second item that you</p> <p>24 mentioned was completeness.</p> <p>25 With respect to what's at issue here, what are you</p>

23 (Pages 1848 to 1851)

Page 1852	Page 1854
<p>1 talking about when you talk about needing assurance about 2 completeness? 3 A. Well, the issue here is, is there something that should be 4 recorded on the accounting that hasn't been captured, either 5 money due the account holder or disbursements that have been 6 made that haven't reduced the account balance. 7 Q. Okay. Now, with respect to completeness with respect to 8 credits in the account, have you seen anything in the 2007 plan 9 that addresses a plan to provide assurance about that all of the 10 collections were properly posted to the correct account? 11 A. There is a discussion of what they call a land-to-dollars 12 test, which is intended, as I understand it, to be a 13 completeness test; that is, that everything that should have 14 been recorded was recorded. And this, as I can tell, is how 15 they attempt to address the completeness assertion. 16 Q. And have you reviewed any documents where some or part of 17 that testing has begun? 18 A. Yes, I reviewed a report from NORC on a pilot test. 19 Q. And where was that pilot test? 20 A. That was at the Horton Agency. 21 Q. That's been referred to here before. And did you review the 22 results of that testing? 23 A. Yes. 24 Q. And what did you, as a CPA in looking at that testing in 25 terms of completeness, find, whether it was satisfactory in</p>	<p>1 MR. DORRIS: If you'll bring up the top part. 2 THE COURT: What's that number again? 3 MR. DORRIS: Yes, sir. 38-1-1 is the Bates page, and 4 it's a March 31, 2007 memo from Susan Hinkins to Jeffrey Zippin 5 on the subject of land-to-dollar completeness test at the Horton 6 Agency. 7 BY MR. DORRIS: 8 Q. Is that the test that you've been talking about? 9 A. Yes, sir. 10 Q. And are these the results that you were referencing earlier? 11 A. Yes, sir. 12 Q. Now let me ask you to look over at Bates page three, at the 13 next to last indented paragraph on Bates page three of this 14 document. And would you take a moment and review that to 15 yourself? 16 A. (Witness complies.) Yes, sir. 17 Q. You see the last sentence in this paragraph, it says, "For 18 the completeness testing, a process is needed to establish the 19 necessary steps for due diligence in determining whether or not 20 there is evidence of potentially missing revenue." 21 Do you see that? 22 A. Yes, sir. 23 Q. How does that relate to completeness that you're talking 24 about? 25 A. Well, that's the whole point. I mean, that is the test</p>
Page 1853	Page 1855
<p>1 terms of completeness or not? 2 A. What I found was it didn't satisfy the completeness 3 objective. 4 Q. Why do you say that? 5 A. Well, what they did was to compare the land records they 6 were able to use, and tried to determine whether there should 7 have been income from certain plots. And for some of them, they 8 thought that perhaps there should be income but didn't find any 9 income, so it was unclear whether there should have been income 10 or not. 11 They recognize in the report that this is a challenge, 12 and indicate that they would have to come up with some sort of 13 test to figure out where -- in cases where there was no income 14 reported, whether there should have been income reported. But 15 that was the very point of this test, was to determine that. 16 So they were unable to achieve the goals of the test 17 for any number of reasons. 18 Q. And did the test indicate that the Horton Agency, or what 19 was being done at the Horton Agency, was representative for 20 other agencies? 21 A. No, what they said was they selected the Horton Agency 22 essentially because it was fairly clean. They expected other 23 agencies to be far more challenging. 24 Q. Let me ask you to look at administrative record document 25 38-1-1.</p>	<p>1 we're looking to see. So what they're saying here is they still 2 need to design this test. So I don't know whether it's going to 3 be an effective test or not, because not only has it not been 4 applied, it hasn't even been designed at this point. 5 Q. Now, Mr. Pallais, I'm going to ask you to assume that it is 6 not possible to confidently know for a particular area that you 7 have all of the leases. Okay? Based on that, do you -- based 8 on your 30 years of experience, do you know of any way to design 9 a test that will then provide assurance regarding the 10 completeness of what's being called land-to-dollars? 11 A. Not any practical way. 12 Q. Now, Mr. Pallais, I want to go back to the -- you've talked 13 about with control issues and reliance on internal documents. 14 Is it permissible for -- if you have a company that has internal 15 control issues, is it permissible for one division of the 16 company to rely on another division's internal documents to 17 reconcile and overcome the internal control issues of the 18 company? 19 A. No, that's part of this same internal control system, so you 20 would need -- they would be subject to presumably the same 21 control environment, and it's still considered to be an internal 22 document. It's not an external document. 23 Q. Okay. Let's go back to the Accounting Standards Manual, 24 which is 44 -- we're going to look at 44-1-8 that I think has 25 been up on the screen before today.</p>

24 (Pages 1852 to 1855)

Page 1856	Page 1858
<p>1 MR. DORRIS: And I don't know, can you pull the</p> <p>2 highlighting off of that for us?</p> <p>3 BY MR. DORRIS:</p> <p>4 Q. And can you tell us from the Accounting Standards Manual</p> <p>5 just what this chart is?</p> <p>6 A. This chart discusses some of the things that will not be</p> <p>7 tested as part of the reconciliation process.</p> <p>8 Q. I want to ask you about two of those, please, sir. I want</p> <p>9 to ask you about item number two and item number five. And what</p> <p>10 does item two tell you?</p> <p>11 A. Item two tells me that rather than actually testing oil and</p> <p>12 gas amounts, they're going to rely on MMS testing to provide</p> <p>13 them assurance about this.</p> <p>14 Q. Based on what you have reviewed, is that adequate from a CPA</p> <p>15 standpoint?</p> <p>16 A. No, it's not.</p> <p>17 Q. Why do you say that?</p> <p>18 A. Well, in order to rely on MMS, MMS work needs to be</p> <p>19 reliable. And what I've seen historically is that MMS' work has</p> <p>20 been judged not reliable.</p> <p>21 Q. And why do you say that?</p> <p>22 A. Well, certainly reports to Congress have indicated that over</p> <p>23 the years MMS is not reliable. But we also have essentially an</p> <p>24 audit of MMS. The Inspector General of the Interior Department</p> <p>25 did an audit of the MMS audit system to see whether it could be</p>	<p>1 you?</p> <p>2 A. This tells me that as part of the reconciliation process,</p> <p>3 the accountants are not going to actually test the allocation of</p> <p>4 income to various parties that have leasehold interests.</p> <p>5 Q. What are they going to rely on?</p> <p>6 A. It says they're going to rely on BIA documents and an audit,</p> <p>7 which is -- or a verification, it doesn't say an audit, a</p> <p>8 verification which is undescribed in this document.</p> <p>9 So I have no basis to conclude whether -- what that</p> <p>10 verification might seek to prove.</p> <p>11 Q. Okay. But at least they're saying, we're going to rely on</p> <p>12 the BIA documents, but there is going to be some process for</p> <p>13 verification?</p> <p>14 A. That's what it promises.</p> <p>15 Q. But this does not -- the Accounting Standards Manual does</p> <p>16 not set that process out?</p> <p>17 A. That's correct. It's not described, so I can't figure out</p> <p>18 whether it would even be possible for this to be a reliable</p> <p>19 document.</p> <p>20 Q. Is verification a term of art in auditing standards?</p> <p>21 A. It's a term we try to avoid in auditing standards.</p> <p>22 Q. Why do you say that?</p> <p>23 A. It implies a level of assurance we generally can't get to.</p> <p>24 Q. Now let me ask you to look back at the Accounting Standards</p> <p>25 Manual on page seven, so it would be administrative record Bates</p>
Page 1857	Page 1859
<p>1 relied on, and what the Inspector General determined --</p> <p>2 MR. SIEMIETKOWSKI: Objection, Your Honor. Hearsay.</p> <p>3 THE COURT: This is referring to public documents, I</p> <p>4 think. I'm going to allow it. It's not -- I don't know whether</p> <p>5 it's not for the truth, but it's what the Inspector General</p> <p>6 found, is what this man is saying.</p> <p>7 MR. DORRIS: And I think --</p> <p>8 THE COURT: I'll allow it.</p> <p>9 BY MR. DORRIS:</p> <p>10 Q. Go ahead.</p> <p>11 A. And what the Inspector General's report says, is that the</p> <p>12 system, quality control system used by MMS, is unreliable. It</p> <p>13 was an adverse report on quality control at MMS. And in</p> <p>14 addition, they found individual problems in many of the audits</p> <p>15 they looked at.</p> <p>16 So in order to rely on MMS to do adequate audits, you'd</p> <p>17 have to have some evidence that they do adequate audits, and</p> <p>18 what the Inspector General says is, they don't.</p> <p>19 Q. And as part of the 2007 plan and the process there, is the</p> <p>20 Department of Interior looking at and testing the reliability of</p> <p>21 the information on which they're using from MMS?</p> <p>22 A. No.</p> <p>23 Q. And how do you know that?</p> <p>24 A. That's what this says.</p> <p>25 Q. Okay. Item five here on this chart, what does this tell</p>	<p>1 page 44-1-7.</p> <p>2 MR. DORRIS: And would you blow up the second</p> <p>3 paragraph? And would you come down to the fifth line, and over</p> <p>4 to the right there?</p> <p>5 BY MR. DORRIS:</p> <p>6 Q. Mr. Pallais, it says, "The statement of accuracy is based on</p> <p>7 the results of the reconciliation of transactions, defined as an</p> <p>8 examination of the original financial documents and related</p> <p>9 records to determine whether the transaction, as recorded,</p> <p>10 accurately reflects the proper allocation of collection,</p> <p>11 interest, or disbursement of funds."</p> <p>12 Do you see that?</p> <p>13 A. Yes.</p> <p>14 Q. And in looking at that, is this where the Accounting</p> <p>15 Standards Manual indicates what the purpose or the intended</p> <p>16 results are of this reconciliation process?</p> <p>17 A. Yes.</p> <p>18 Q. And in your opinion, based on the procedures that are set</p> <p>19 out here and based on what you have gathered from your review of</p> <p>20 documents and audits, will following the ASM procedures end up</p> <p>21 resulting in a determination that the transaction as recorded</p> <p>22 accurately reflects the proper allocation of collection,</p> <p>23 interest, or disbursement of funds?</p> <p>24 A. No.</p> <p>25 Q. And why do you say that?</p>

25 (Pages 1856 to 1859)

Page 1860	Page 1862
<p>1 A. Well, there are a couple of problems. It says that it's 2 going to be an examination of original financial documents, and 3 most of the procedures called for in the Accounting Standards 4 Manual are not looking at original financial documents, they're 5 looking at internal records. 6 It says that the examination will determine whether the 7 transactions recorded accurately reflects. And in a lot of 8 cases, particularly for the alternative procedures, it doesn't 9 actually determine. The best we can do is infer. So we might 10 be able to infer that a transaction took place, but we really 11 can't determine it. 12 And then it says, "Accurately reflects the proper 13 allocation of collection, interest, or disbursement of funds." 14 And to determine propriety, you not only have to test what's 15 been recorded but what hasn't been recorded. 16 And what's unique about the completeness assertion is 17 that it's the only one that can't be tested directly by looking 18 at recorded amounts. You've got to look at something else to 19 test completeness, and there's very little in the Accounting 20 Standards Manual that provides any assurance at all about 21 completeness. 22 MR. DORRIS: Your Honor, I'm getting ready to move to 23 another item. It's going to take about 10 minutes. I don't 24 know if you want to take the lunch break now? 25 THE COURT: We just had a break, but it is lunchtime.</p>	<p>1 CERTIFICATE OF OFFICIAL COURT REPORTER 2 3 I, Rebecca Stonestreet, certify that the foregoing is a 4 correct transcript from the record of proceedings in the 5 above-entitled matter. 6 7 8 9 10 SIGNATURE OF COURT REPORTER DATE 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25</p>
Page 1861	
<p>1 We'll be in recess now for lunch. Back in an hour, please. 2 (Recess taken at 12:35 p.m.) 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25</p>	

26 (Pages 1860 to 1862)